

Monthly Report of Prospects for Japan's Economy

April 2019

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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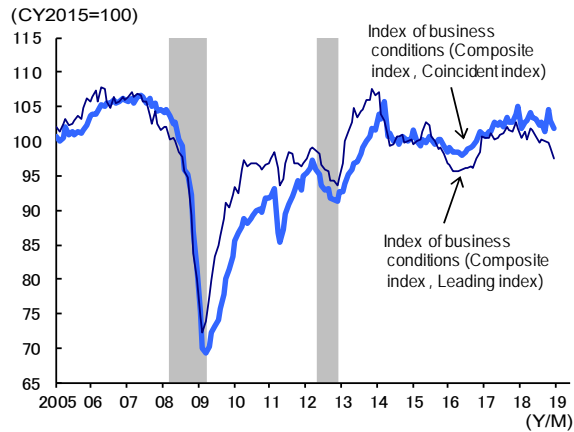
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The General Situation of Japan's Economy – A Sense of Standstill Is Felt in Economic Activity

Figure 1-1 Economic Activity

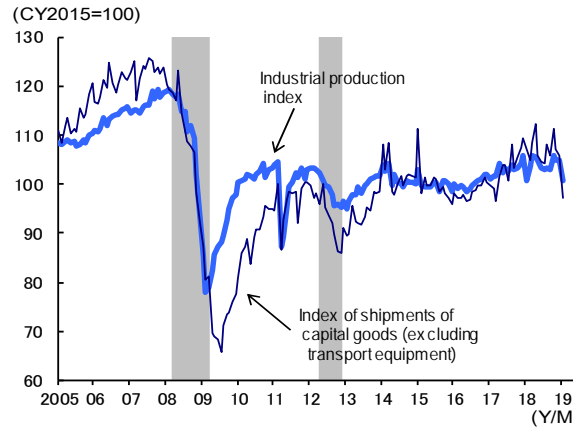
The CI coincident index declined against the backdrop of falling wholesale sales and shipment of investment goods.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

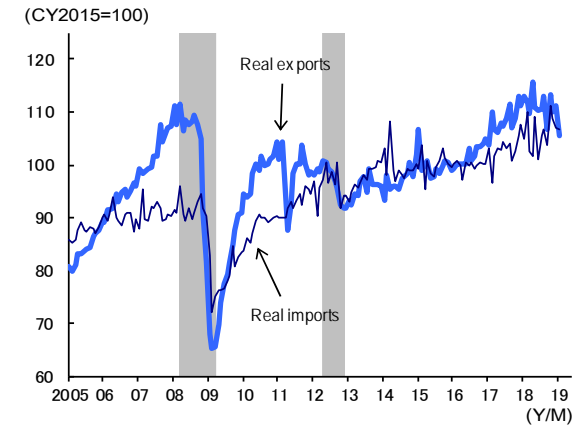
Industrial production dropped, mainly due to lower exports of capital goods.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

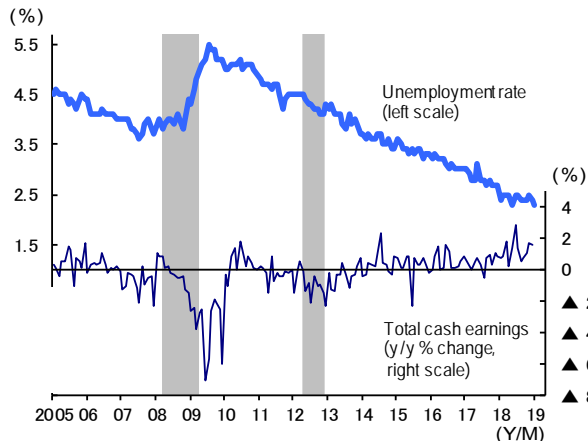
Exports saw a substantial decrease, mainly exports to China. Imports remained practically flat.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is hovering near a 25-year low. Nominal wages remained on a rising trend despite fluctuations.

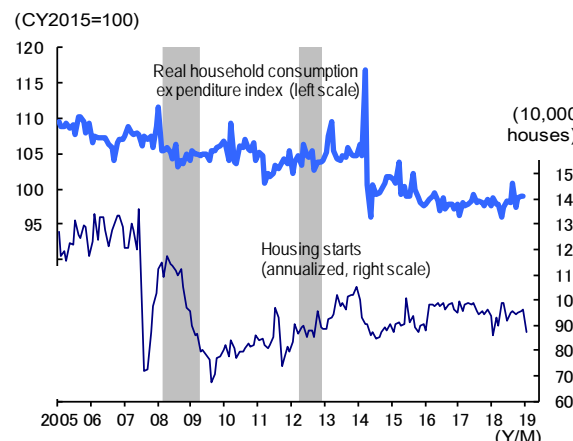


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

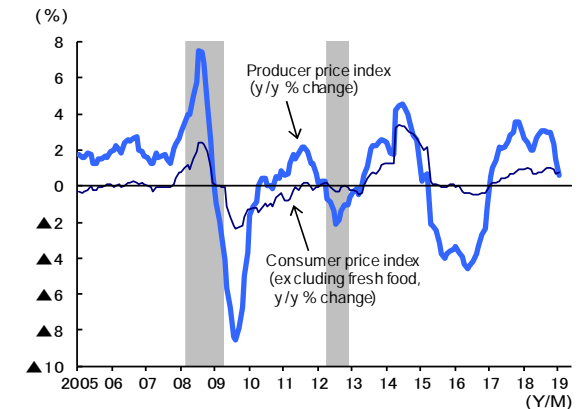
Real household consumption has picked up. Housing starts significantly dropped for rental housing and subdivision housing.



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

Figure 1-6 Prices

The rate of year-on-year increases in producer and consumer prices has slowed due mainly to lower crude oil prices.



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

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Domestic Demand Is Firm, While Overseas Demand Is Sluggish

◆ The Growth Rate for the October-December Period Turned Positive

Japan's real GDP in the October-December period increased by 1.9 percent on an annualized quarter-on-quarter change basis for the first time in two quarters (the second preliminary estimates), reflecting the dissipation of negative impact due to natural disasters. However, this increase was not enough to compensate for a decline in the previous quarter (minus 2.4 percent on an annualized quarter-on-quarter change basis) as the contribution of overseas demand turned negative against the backdrop of sluggish exports mainly to China.

◆ Industrial Production Has Been Sluggish

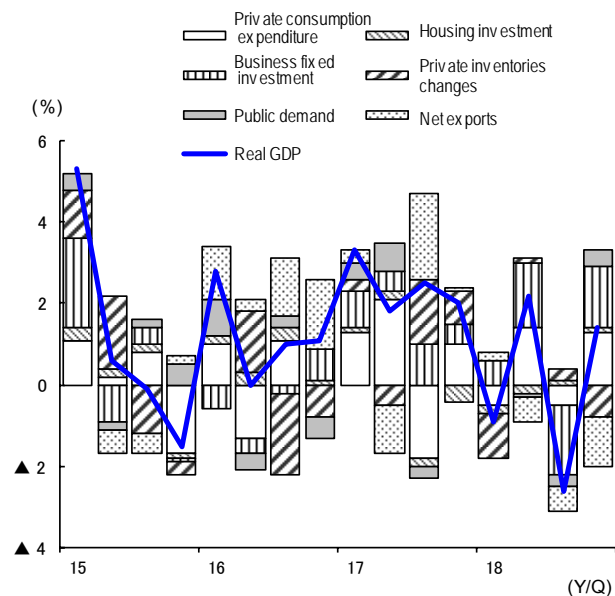
Manufacturing activity appears to have stalled. The industrial production index for January was down 3.4 percent from the previous month, making the third consecutive month of lower production. Against the backdrop of a decline in exports, production has turned downward for a wide range of industries including

transportation equipment and production machinery. The outlook for February is +0.4 percent on a month-over-month basis (METI's estimate, after correcting for a bias error in the forecasting index) while that for March is -1.6 percent on a month-over-month basis, indicating bleak prospects for recovery.

◆ The Household Sector Is Making a Mild Recovery

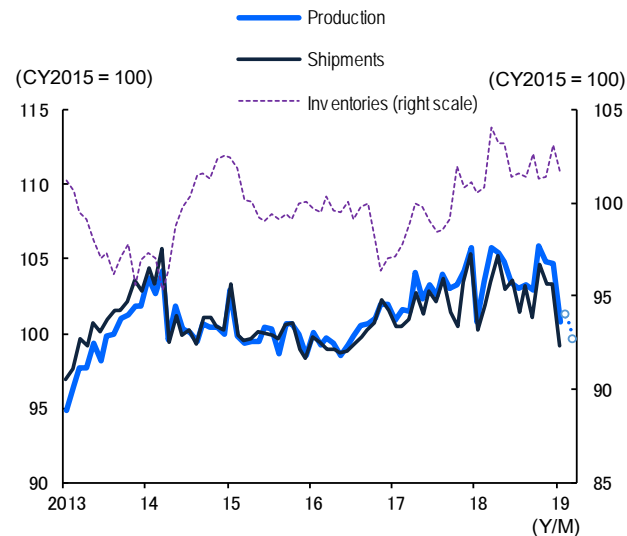
Despite the foregoing, employment and income conditions continued to improve. The unemployment rate is hovering near a 25-year low, indicating that labor supply demand conditions remain tight. Total cash earnings for December were up 1.5 percent year-on-year, showing continued expansion. Under such circumstances, private consumption is gradually recovering. Although consumer sentiment is weak against a backdrop of falling share prices, wage income of employees remained on a mild increasing path. The Synthetic Consumption Index maintained its recovery trend on the whole reflecting resilient income conditions.

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



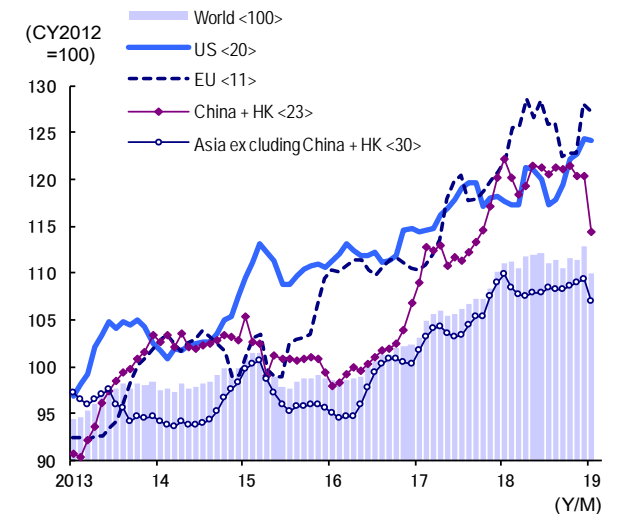
Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Figure 2-2 Industrial Production Index
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.
Note: The latest two figures in the industrial production index are forecasts for February and March based on METI's estimate and the production forecast index, respectively.

Figure 2-3 Real Exports by Destination
<seasonally adjusted, 3-month moving averages>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2017.

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Exports Are Sluggish

◆ Exports of Goods Have Slowed Down

Exports of goods saw a decline across a wide range of items, mainly among those to China. Amid further slowdown of the Chinese economy, exports of intermediate goods, capital goods and electronic parts and devices significantly fell. Exports to ASEAN countries, which are prone to the influence of the Chinese economy, also decreased.

Looking at future prospects, growth of exports of goods is likely to remain sluggish. This is primarily attributable to the decline of exports to China which will likely continue to suffer from economic slowdown, despite robust exports to developed countries continuing to enjoy economic stability.

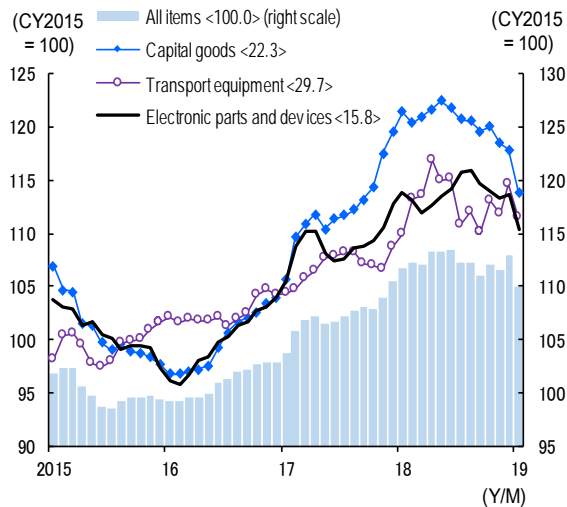
Possible intensification of Japan-US trade friction poses the risk of greater downward pressure on exports. While the start of Japan-US talks on a Trade

Agreement on Goods (TAG) has deferred higher automobile tariffs for the time being, any quantitative restrictions on automobile exports and/or foreign exchange provisions incorporated into this agreement could have a significant impact on Japan's exports.

◆ Demand Related to Inbound Tourism Is Rebounding

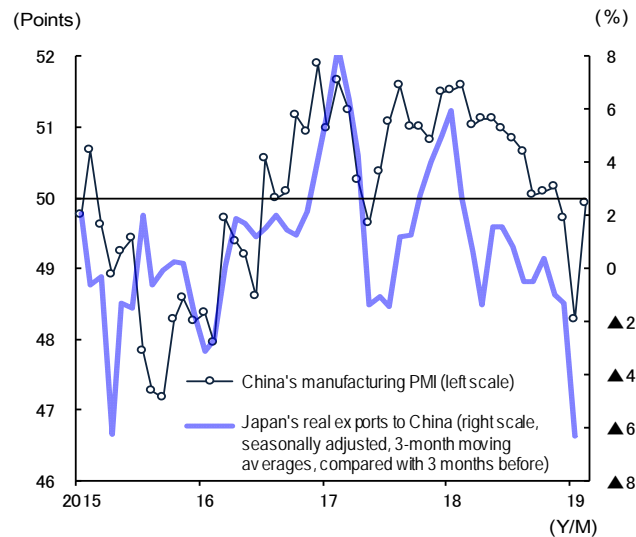
Looking at demand related to inbound tourism, both the number of tourists and the amount of consumption have remained at levels exceeding those prior to the slump period due to natural disasters. In terms of future outlook, demand related to inbound tourism is expected to continue growing, propelled by an expanding middle class in emerging Asian countries and better infrastructure and services for receiving tourists in Japan.

Figure 3-1 Real Exports by Item
<seasonally adjusted>



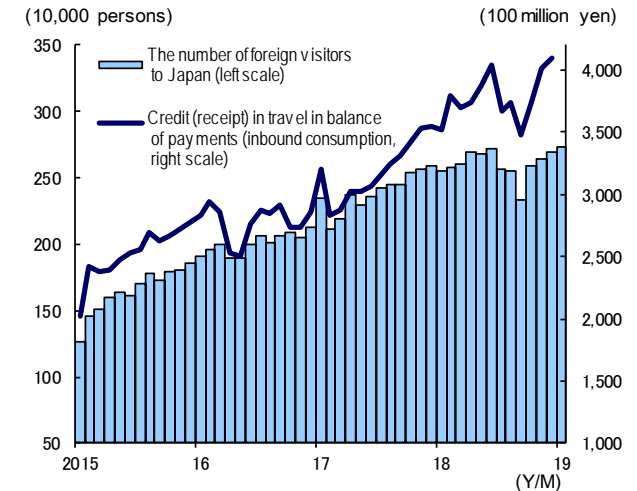
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note: 1. Figures in the angled brackets show the shares in total nominal exports in CY2018.
2. 3-month moving averages.

Figure 3-2 China's Manufacturing PMI and Japan's Exports to China



Source: The Japan Research Institute, Ltd. based on data of Caixin / IHS Markit, The Ministry of Finance.

Figure 3-3 Receipt in Travel in Balance of Payments
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, Japan National Tourism Organization (JNTO).

Business Fixed Investment Continues on a Recovery Trend

◆ Momentum in Corporate Profit Growth Has Stalled

While corporate earnings have remained at a high level, a slight sluggishness is observed currently. According to the Financial Statements Statistics of Corporations by Industry quarterly report, current profits for the period October-December 2018 declined for the second consecutive quarter, albeit an increase in sales value for the same period for the fifth consecutive quarter. Profits in manufacturing, in particular, saw a substantial drop of 10.6 percent from the preceding quarter. While the increase in labor costs has been curtailed, a rise in variable costs, due to higher crude oil prices which had continued until the beginning of the fall, pushed down profitability.

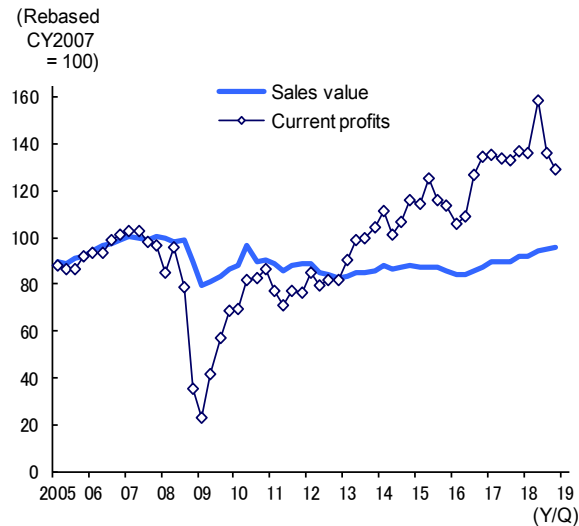
Nonetheless, it is unlikely that corporate profits will continue to decline. Looking at the future outlook, corporate earnings will likely start to increase again as variable costs are anticipated to start to decline due to a drop in crude oil prices.

◆ Business Fixed Investment Is on a Gently Rising Trend

Capital investment has remained on an upward trend. Investment in rationalization and labor-saving efforts to address labor shortages as well as investment in maintenance/upgrades to combat obsolescence will continue to be the drivers. The increase in business fixed investment during the October-December period partially reflected the reactionary impact to the slump due to a series of natural disasters during the summer.

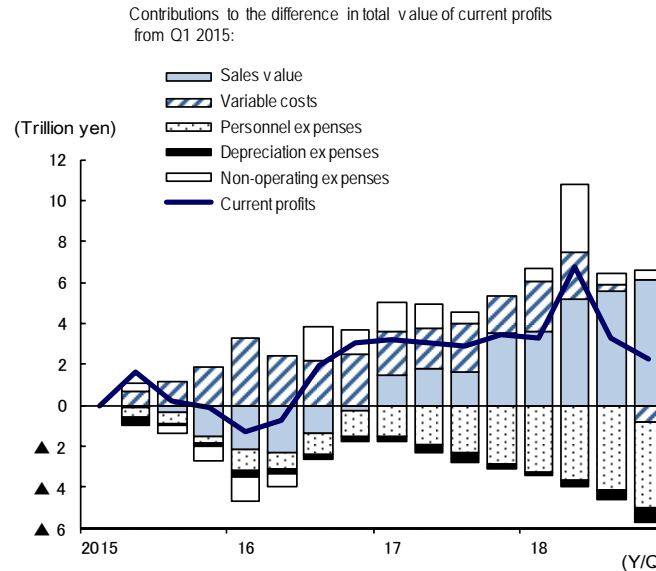
As for the future outlook, although a slight slowdown is anticipated owing to increasing uncertainties such as a slowing Chinese economy among other factors, the strong need for rationalization and labor-saving investment makes it very unlikely that capital investment will slump. Machinery orders, which have been sluggish, are expected to pick up any time soon.

Figure 4-1 Sales Value and Profits of Japanese Enterprises
<seasonally adjusted>



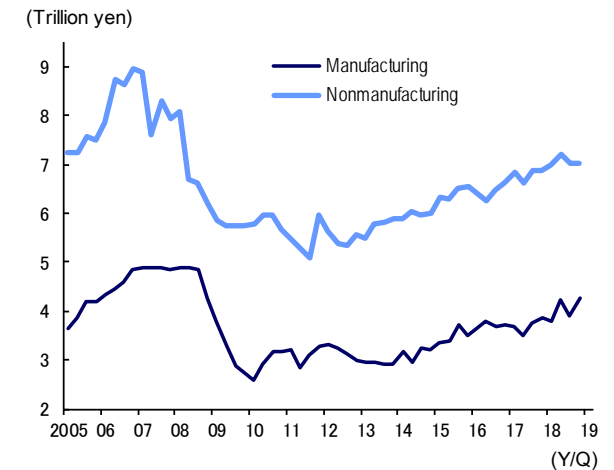
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 4-2 Contributions of Factors to Change in Total Value of Current Profits
<seasonally adjusted>



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

Figure 4-3 Value of Business Fixed Investment of Corporations
<seasonally adjusted>



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

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Income Is Recovering Steadily

◆ Employment and Income Conditions Continue to Improve

The employment situation continues to improve. There has been a notable increase in the number of regular employees in the manufacturing industry, where there has been booming product development in new fields. The progress of work-style reform has also given momentum to the shift from part-time jobs to full-time jobs.

In addition, labor shortages across all industries at a level exceeding those during the bubble economy have helped slightly accelerate the pace of nominal wage growth. Even after eliminating the effects of sample switchover, the pace of rise in scheduled salaries for full-time workers has been on an upward trend.

◆ Real Income Is Likely to Increase Firmly

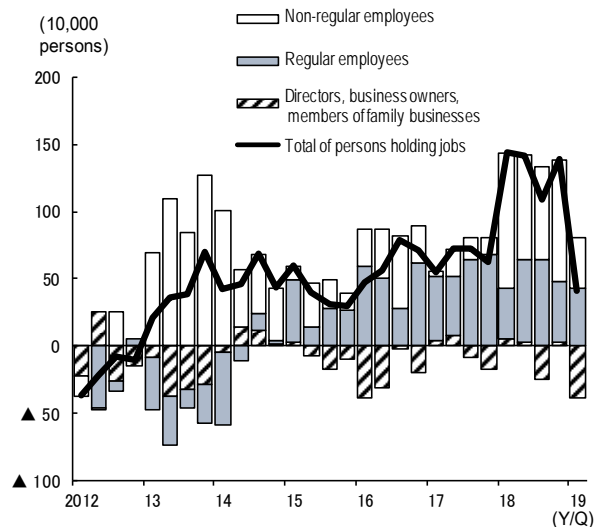
A look at future prospects shows a high likelihood that both the moderate economic recovery and continued population decline will keep labor supply demand conditions

tight. As a result, both employment conditions and nominal wages are expected to continue improving.

The pace of improvement to employment conditions is expected to become moderate gradually. New openings, a leading indicator, have plateaued since the start of 2018 against the backdrop of a decline in the pace of economic recovery among other reasons.

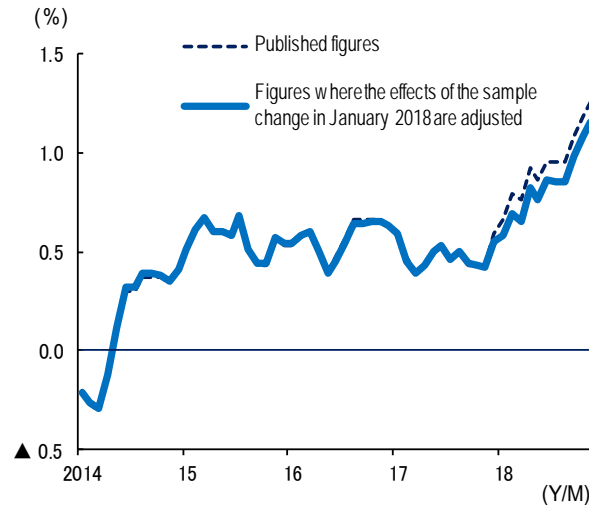
The pace at which real compensation for employees has been improving is expected to ease somewhat from FY2019 onward due primarily to a slowdown in the increase of the number of employees. Nevertheless, because of rising nominal wages and the prospect that provision of free education and nursery care is expected to minimize price increases due to a hike in the consumption tax, growth at around the 2 percent level will likely be maintained.

Figure 5-1 Number of Persons Holding Jobs
<difference from a year earlier>



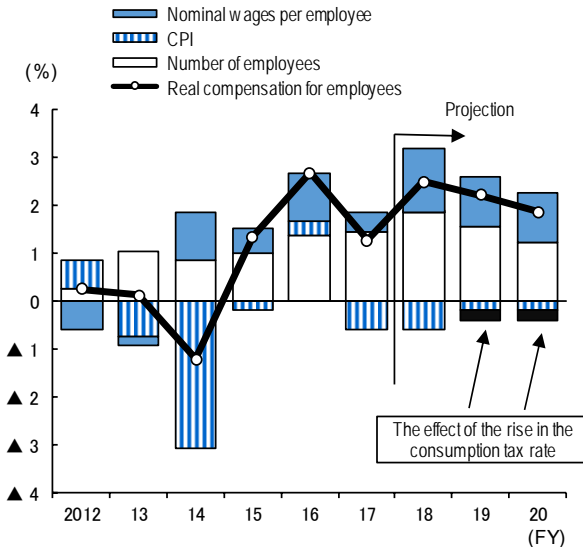
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labor and Welfare.
Note: Regular employees are persons employed for an indefinite period.

Figure 5-2 Scheduled Salaries for Full-time Workers
<year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labor and Welfare.
Note: 3-month moving averages.

Figure 5-3 Real Compensation for Employees
<year-on-year % change>



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

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Private Consumption Expenditure Is Increasing Moderately

◆ Private Consumption Is Increasing Moderately

Although highly susceptible to weather factors, private consumption on the whole made a mild recovery as employment and income conditions improved.

Warm winter temperatures led to a decline in sales of seasonal merchandise such as winter clothing and food products. In addition, worsening consumer sentiment as a result of a decline in share prices and increasing uncertainties over the economic outlook negatively contributed to lack of strength in private consumption.

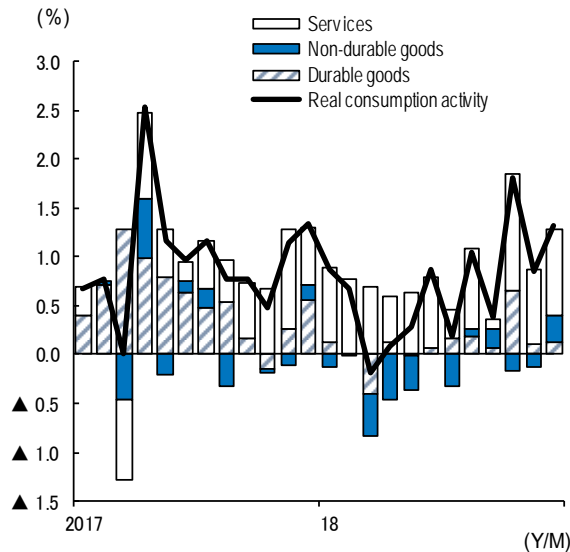
However, service consumption including food service and travel remained on a rising trend on the back of an increase in disposable income. Consumption of durable

goods such as automobiles remained firm thanks to the positive effects of the launch of new vehicle models.

◆ Private Consumption Will Likely Remain on a Mild Recovery Path

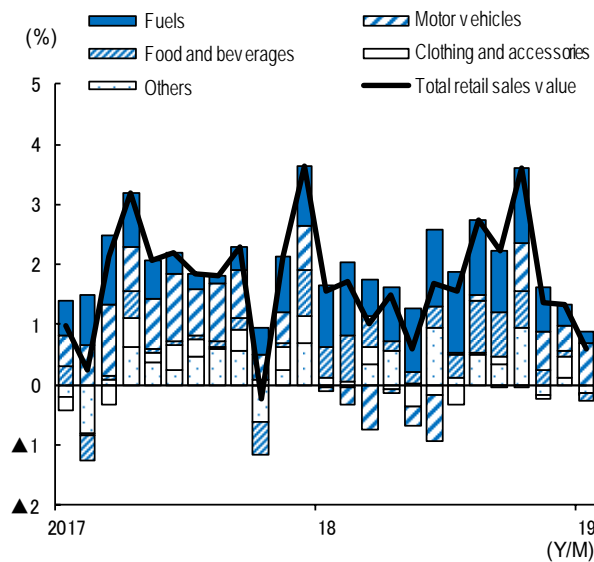
The future outlook is that private consumption will maintain its mild recovery as employment and income conditions continue to improve, albeit with concerns over the worsening of sentiment reflecting unstable share price movements. Private consumption expenditures will likely return to grow in line with the increase in income if consumer sentiment starts to improve again.

Figure 6-1 BoJ's Consumption Activity Index <year-on-year % change>



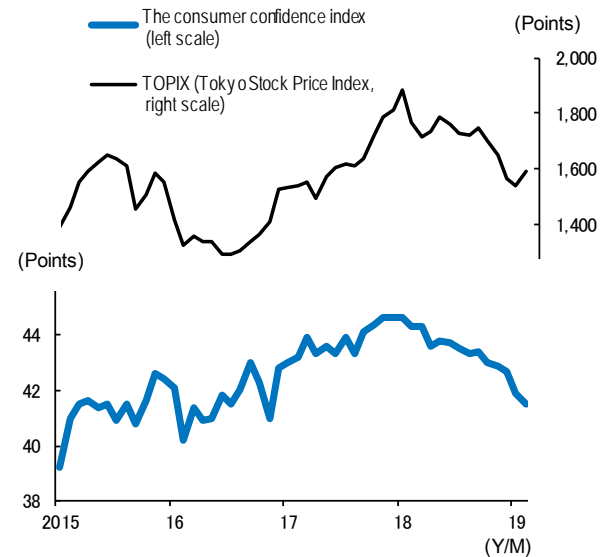
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 6-2 Retail Sales Value by Item <year-on-year % change>



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

Figure 6-3 Consumer Confidence Index and Stock Price Index



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office, Tokyo Stock Exchange.

Topic: What Are the Indications of an Increase in Non-regular Employment?

◆ Non-regular Employment Has Been Rapidly Increasing Among Young Adults and Women

The increase in the number of non-regular employees in Japan accelerated in 2018. By looking at the breakdown by age and gender, the ratio of young adults and women of childrearing age significantly increased in addition to senior citizens.

◆ Enhanced Flexibility in Employment Conditions Contributed to This Change

Enhanced flexibility of employment conditions among companies can be pointed out as the background behind this change. Amid the increasing difficulty of securing workers due to severe labor shortages, companies focused on measures to tap non-workers who had not been able to find a job despite their wishes to be employed.

One measure is flexible working hours. For example, by introducing an employment system limited to short hours per day such as only early in the morning, it has become possible for women of childrearing age to work only during the time

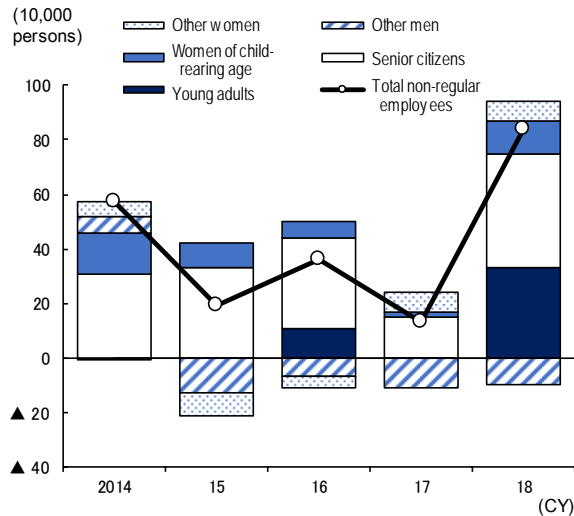
when their children are at childcare services. As a result, the average number of work hours per work day has decreased.

Another measure is reduced work days. By reducing the minimum number of work days, it has become possible for students and others who can work only on specific days to be able to find a job. Given these measures, the ratio of workers who work for 15 days or less in a month has increased.

◆ Flexibility of Work Locations Remains as an Obstacle

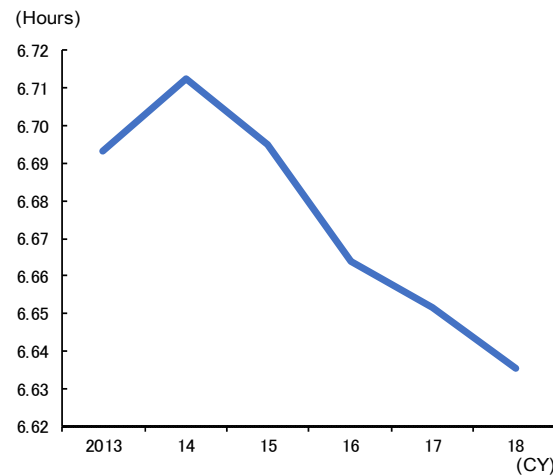
Despite the success of the measures mentioned above, there are still mismatches in employment. For instance, many non-working senior citizens who have challenges in nursing care for their families and their own health issues mention the restriction of work locations as a reason for not being able to work. It is necessary to develop an environment such as teleworking and shared offices in order to eliminate such mismatches due to work locations.

Figure 7-1 Number of Non-regular Employees <change from a year earlier>



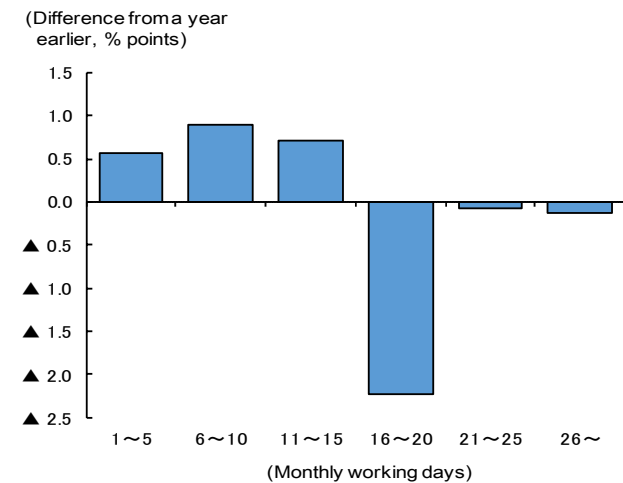
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
 Note: Young adults are for persons 15 - 24 years old, senior citizens are for persons 65 or more of age, women of childrearing age are for women 35 - 54 years old.

Figure 7-2 Work Hours per Work Day in Non-regular Employees



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
 Note: Work hours per work day = average work hours / average work days

Figure 7-3 Change in the Ratio of Each Monthly Work Day Group in Non-regular Employees <CY2018 >



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

Prospects for Japan's Economy - Projected Real GDP Change; 0.8% in FY2019 and 0.9% in FY2020

◆ Moderate Economic Recovery Will Continue, Supported by Solid Domestic Demand

(1) According to the Second Preliminary Quarterly Estimates of GDP (2nd QE), Japan's real GDP for the October-December 2018 period was revised upward to +1.9% on an annualized quarter-on-quarter change basis (up 0.5% from the preceding quarter) from the First Preliminary Quarterly Estimates of GDP (1st QE) (+1.4% on an annualized quarter-on-quarter change basis and up 0.3% from the preceding quarter). Despite a positive revision on the back of higher capital investment, GDP growth remained lackluster, failing to make up for the decline in the July-September 2018 period (down 2.4% on an annualized quarter-on-quarter change basis). The 2nd QE indicated that Japan's economy has been stalling.

(2) As for the future outlook, exports are likely to continue stagnating against the backdrop of moderate slowdown of the global economy. Capital spending, mainly by exporting companies, is expected to lose momentum. However, we hold the view that the Japanese economy will continue recovering, underpinned by domestic demand. As many enterprises hesitated to expand production capacity, they still acutely feel the shortage of facilities. Business fixed investment in the fields of labor saving and rationalization is projected to grow steadily against the backdrop of continued labor shortages. Thus, we think it is unlikely that capital investment will see substantial downward adjustment. In addition, Japan's economy will likely be underpinned by an increase in public investment in the future as a result of the execution of the supplementary budget for FY2018.

(3) Meanwhile, personal consumption is also expected to increase mildly, supported by a solid income environment. A hike in the consumption tax rate is scheduled for October 2019. However, measures to minimize the impact of the consumption tax rate hike, such as the introduction of a reduced tax rate and provision of free education and nursery care, are expected to reduce the burden on households. Therefore, we believe that a sharp drop in consumer spending is likely to be avoided.

(4) Consequently, the Japanese economy is expected to grow moderately for FY2019 and FY2020 at around the 1.0% level, which is close to its potential growth rate.

(5) However, attention must be paid to a possible economic downturn caused by deterioration of the external environment as the outlook for overseas economies remains increasingly uncertain. The movements of the Chinese economy with a growing sense of economic slowdown, in particular, will remain as a significant risk factor. As the Chinese government has been making infrastructure investment and taking consumption stimulus measures, it is likely that rapid economic slowdown will be avoided. However, if downward pressure on the Chinese economy increases due to the adjustment of excess capacity and debt overhang, a decline in Japan's exports and market adjustment will likely put downward pressure on the mindsets of households and the corporate sector, resulting in a significant negative impact on Japan's economy.

◆ The Year-on-year Change Rate in the Core CPI Will Likely Continue to Be Slightly below 1 Percent

(6) The pace of rise in the core CPI, which excludes fresh food, accelerated slightly because positive contributions of the rise in prices such as accommodation charges expanded while the extent of increase in energy prices narrowed. Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will continue to be slightly less than 1 percent. This is because, while the upward pressure will likely strengthen from the supply-demand perspective due to improvement in employment and income conditions, the pace of rise in energy prices will likely continue to decelerate.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of March 8, 2019)

	(seasonally adjusted, annualised % changes from the previous quarter)										(% changes from the previous fiscal year)		
	CY2018	CY2019				CY2020				CY2021	FY2018	FY2019	FY2020
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)	(Projection)
	(Actual)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	1.9	0.5	1.8	2.6	▲ 3.7	2.3	1.6	2.2	▲ 0.9	1.3	0.6	0.8	0.9
Private Consumption Expenditure	1.6	1.2	1.8	4.4	▲ 8.5	3.9	2.2	2.4	▲ 0.9	1.3	0.6	0.8	0.8
Housing Investment	4.6	3.4	3.2	0.0	▲ 4.5	▲ 3.1	0.8	1.3	1.8	2.0	▲ 4.3	1.4	▲ 0.4
Business Fixed Investment	11.3	▲ 1.7	2.2	3.9	▲ 1.6	2.2	2.4	2.4	2.2	2.1	3.3	1.6	1.9
Private Inventories (percentage points contribution)	(0.1)	(▲ 0.3)	(0.0)	(▲ 0.4)	(0.3)	(0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(0.1)	(▲ 0.0)	(0.0)
Government Consumption Expenditure	3.0	0.4	0.6	0.7	0.7	0.9	1.0	2.2	▲ 1.1	1.2	0.9	0.9	0.9
Public Investment	▲ 6.8	2.9	8.2	2.9	0.4	▲ 1.8	▲ 2.1	▲ 0.2	0.0	0.0	▲ 4.3	1.8	▲ 0.7
Net Exports (percentage points contribution)	(▲ 1.2)	(0.1)	(▲ 0.1)	(▲ 0.4)	(1.1)	(▲ 0.3)	(▲ 0.2)	(0.0)	(▲ 0.5)	(▲ 0.0)	(▲ 0.2)	(▲ 0.2)	(▲ 0.0)
Exports of Goods and Services	4.0	▲ 2.5	2.3	2.6	2.6	2.0	1.5	3.2	▲ 1.7	1.8	1.7	1.2	1.7
Imports of Goods and Services	11.3	▲ 2.8	2.9	4.9	▲ 3.8	3.7	2.5	3.1	1.3	2.1	3.0	2.0	2.0
(Ref.) Domestic Private Demand (percentage points contribution)	(2.8)	(0.2)	(1.5)	(2.7)	(▲ 4.9)	(2.5)	(1.7)	(1.8)	(▲ 0.1)	(1.1)	(0.8)	(0.7)	(0.8)
(Ref.) Public Demand (percentage points contribution)	(0.2)	(0.2)	(0.5)	(0.3)	(0.2)	(0.1)	(0.1)	(0.4)	(▲ 0.2)	(0.2)	(▲ 0.0)	(0.3)	(0.1)

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	▲ 0.1	1.2	1.3	2.6	1.7	1.6	1.6	1.4	1.8	1.6	0.6	1.8	1.6
GDP deflator	▲ 0.3	0.8	0.7	0.9	1.5	0.9	0.9	0.9	0.5	0.5	▲ 0.0	1.0	0.7
Consumer Price Index (excluding fresh food)	0.8	0.8	0.7	0.7	1.0	1.2	1.0	1.1	0.9	0.8	0.8	0.9	0.9
(excluding fresh food, consumption tax, education free of charge)	0.8	0.8	0.7	0.7	0.7	0.8	0.7	0.8	0.9	0.9	0.8	0.7	0.8
Unemployment Rate (%)	2.4	2.4	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.1	2.4	2.3	2.2
Exchange Rates (JY/US\$)	113	111	111	110	109	109	108	108	107	107	111	110	108
Import Price of Crude Oil (US\$/barrel)	78	64	67	68	68	68	68	68	68	68	72	68	68

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 : "▲" indicates minus.