Monthly Report of Prospects for Japan's Economy

May 2024

Macro Economic Research Center

Economics Department

The Japan Research Institute, Limited

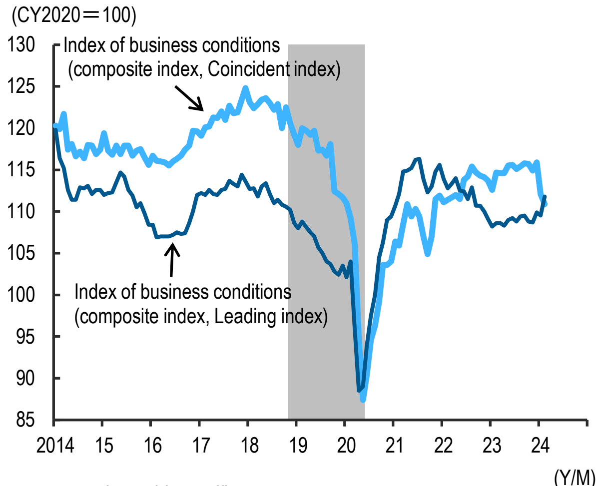
https://www.jri.co.jp/english/periodical/

This report is the revised English version of the April 2024 issue of the original Japanese version.

The General Situation – The economic recovery has stalled

Figure 1-1 Economic Activity

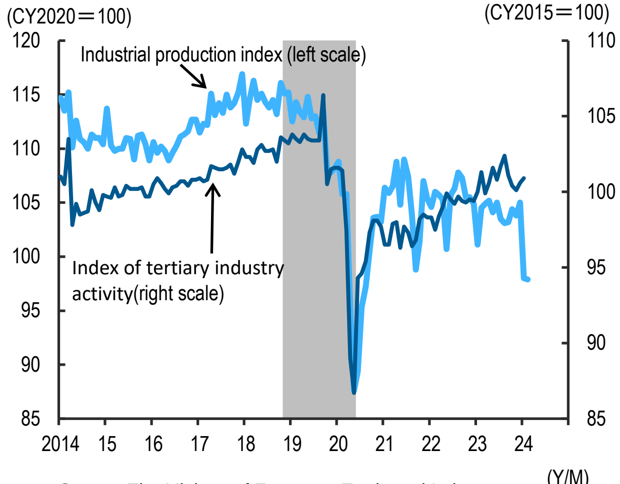
The Coincident index of business conditions is falling substantially.
The leading index is improving.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

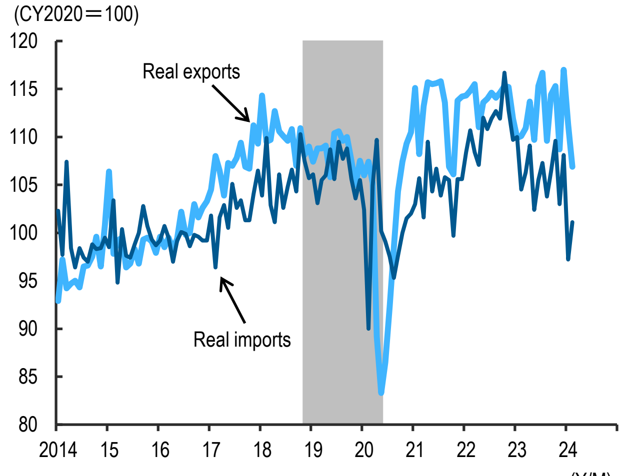
Industrial production is declining, centered on automobiles.
Economic activity in the service sector has been weak since last fall.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

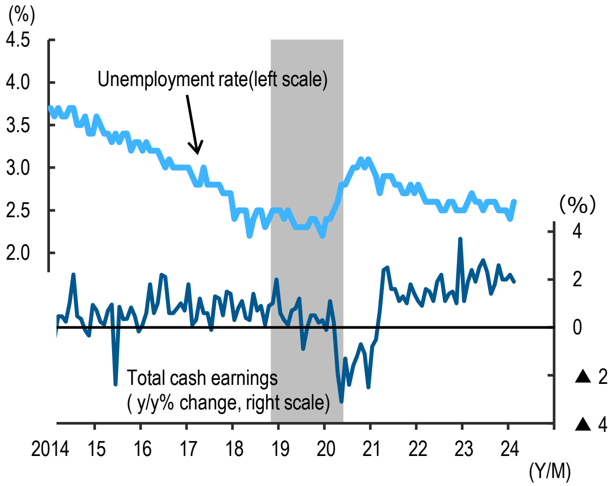
Exports, particularly of automobiles, are decreasing.
Imports of energy-related products are falling.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

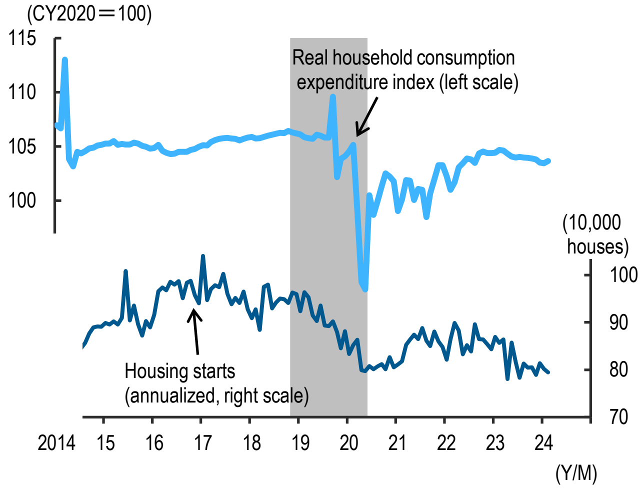
The unemployment rate fell to the mid-2% range.
Nominal wage growth remained around 2%.



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

Figure 1-5 The Household Sector

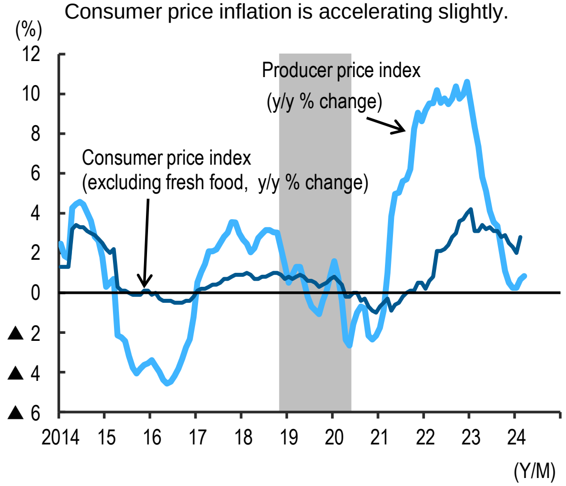
Consumption remained on a recovery track.
Housing starts showed weak developments.



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

Figure 1-6 Prices

Corporate price inflation is hovering in the 0% range.
Consumer price inflation is accelerating slightly.



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

＊The shaded area indicates the recession phase.

Business confidence is improving overall

◆ Business confidence in the non-manufacturing sector has picked up significantly

In the Bank of Japan's March Tankan Survey, the diffusion index (DI) for business conditions for large manufacturing enterprises decreased by two percentage points from the previous survey, falling for the first time in four quarters. Background factors included a huge slump in automobile sales due to the issue of performance test irregularities at certain automakers. The DIs for manufacturing enterprises other than automakers were generally unchanged from the previous quarter. The DI for large non-manufacturing enterprises rose for the eighth consecutive quarter, increasing by two percentage points. This reflected the recovery in inbound demand and higher profit margins due to price pass-through. Furthermore, progress with digitalization has given a big boost to business confidence in the information and communications sector.

◆ Manufacturing activity has temporarily stalled

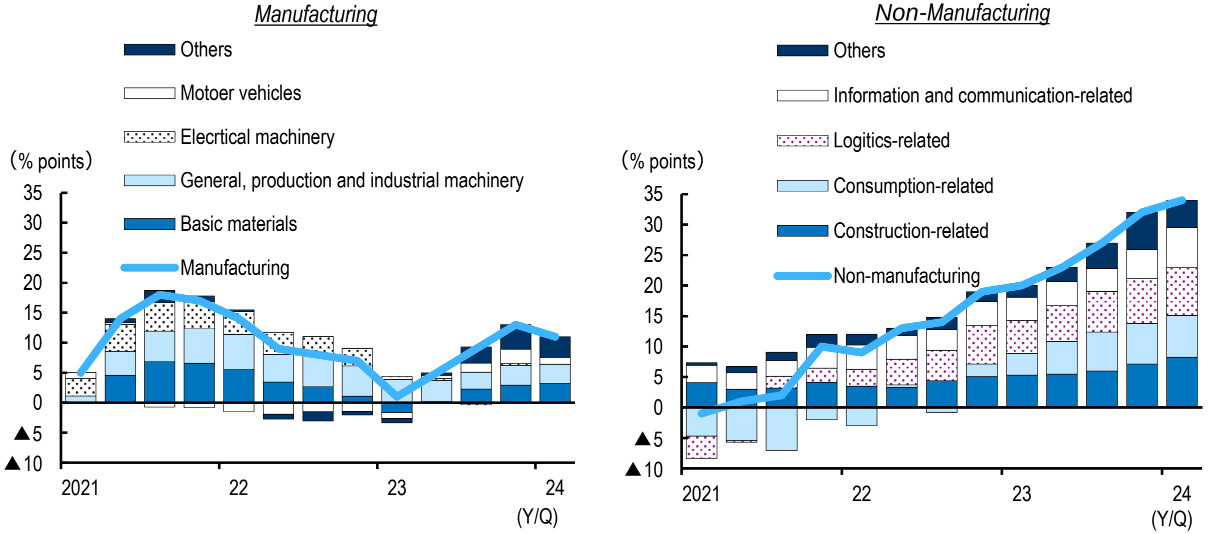
In February, the Industrial Production Index fell for the second straight month, slipping 0.1% from the previous month. Companies in seven out of 15 sectors reduced production, with output of transportation machinery falling by a particularly wide margin. The main factor was the suspension of automobile shipments by certain manufacturers due to performance test irregularities.

Near-future production plans indicate increases in output in March (+4.9% month over month (MoM)) and April (+3.3% MoM). As the impact of the suspension of automobile production and shipment subsides, output is expected to pick up, especially in transportation machinery.

◆ Inbound demand has recovered

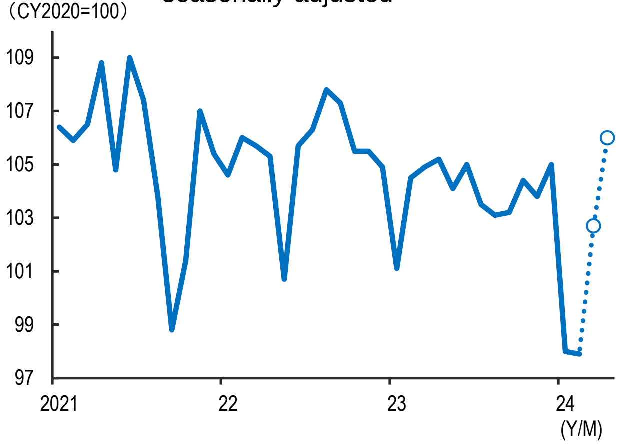
The number of foreign visitors to Japan in February was 2.79 million, up 7.1% compared to the same month in 2019, before the COVID pandemic struck. Visitors from East Asia and the U.S. have continued to increase in number, and the number of Chinese visitors to Japan is now also recovering rapidly.

Figure 2-1 DI for Business Conditions of Large Companies



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

Figure 2-2 Index of Industrial Production <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.
.Note:Dotted lines are postponed based on the forecast index of manufacturing production (March and April).

Goods exports are on the verge of picking up

◆ Slowing global demand for goods is weighing on exports

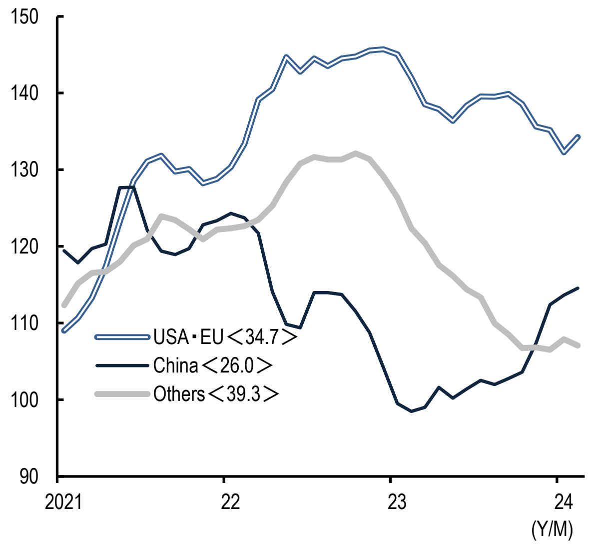
Goods exports are sluggish. In terms of sector, exports of transportation machinery have dipped due to the impact of such factors as the suspension of shipments from some automakers. Although the decline in exports of electronic components and devices has stopped, a full-fledged recovery has yet to commence. As for capital goods, exports to the West lacked strength, owing chiefly to the backdrop of reduced appetite for capital investment due to past monetary tightening, though exports to China have turned the corner recently.

◆ Demand for goods is on the way to picking up

The impact of automakers' suspensions of shipments looks set to cause a dip in exports in the near term. Subsequently, exports are expected to rebound, supported by a recovery in cyclical demand for goods.

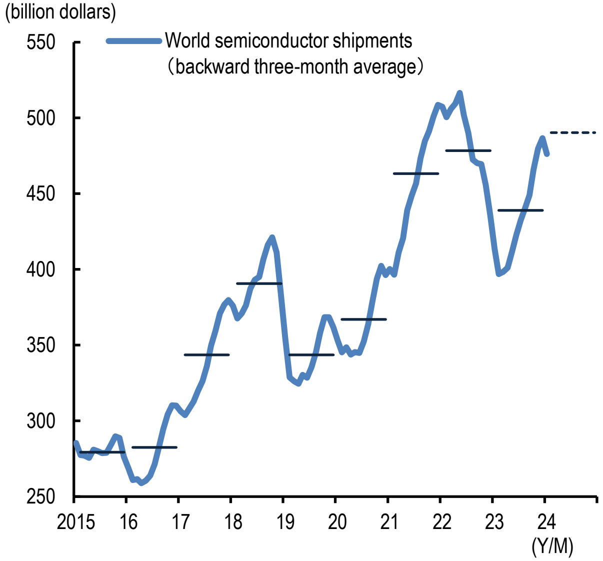
The new PCs and smartphones purchased during the boom in stay-home-related demand during the pandemic are aging, and will soon need to be replaced. Furthermore, demand for semiconductors is recovering worldwide on the back of higher demand related to GenAI. In addition, the worst is over for capacity utilization rates at global companies, and firms are feeling more inclined to make capital investments. This has led to a bottoming out in orders received overseas by Japanese machinery makers. Going forward, demand for goods overseas will recover, and a resurgence in demand for electronic components and capital goods will support the overall economy.

Figure 3-1 Real Capital Goods Exports by Region <seasonally adjusted>



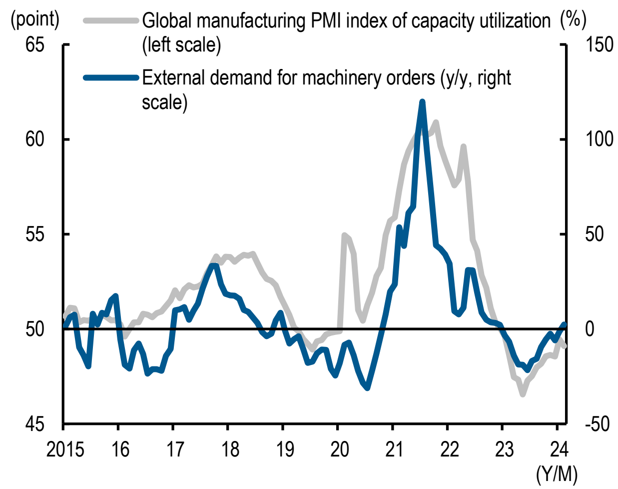
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan,Ministry of Finance.
Note: <>Figures in parentheses represent the share of total nominal capital exports in 2023.Backward 3-month moving average.

Figure 3-2 World Semiconductor Shipments



Source: WSTS.
Note: Dotted line is WSTS annual average forecast.

Figure 3-3 Global Manufacturing PMI Equipment Capacity Utilization and External Demand for Machinery Orders



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office,S&P Global.
Note: External demand for machinery orders is backward 3-month moving average.

The situation for households is gradually improving

◆ Real wage growth will turn positive in the summer

In February, basic salaries of ordinary workers grew at the faster pace of 2.3% year over year (YoY). The hourly pay of part-time workers climbed 3.8% YoY, continuing to rise at a rapid clip. However, the average rise in workers' wages is still not keeping pace with consumer price inflation, with real wages falling 1.3% YoY for the 23rd consecutive month of negative growth.

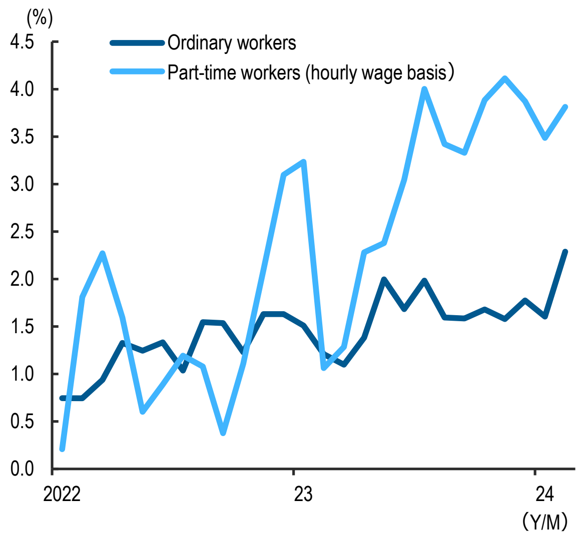
Going forward, wage growth rates are expected to increase. According to the third announcement by Rengo (Japan's largest union group) on the outcome of the shunto (annual pay negotiations), the companies surveyed are set to hike wages by 5.24% (including regular salary increases) on average in 2024, marking the highest rise in 33 years. Background factors that can be pointed to include strong corporate profits, rising prices, and intensifying labor shortages. Heading into the summer, more companies will be implementing the wage hikes agreed during the shunto, and nominal wage growth rates are expected to quicken, with the basic salaries of ordinary workers the main beneficiary. This should result in real wage growth turning positive in the July-September quarter.

◆ New car sales are sluggish

In March, sales of new vehicles decreased by 7.7% MoM for the fifth month of decline in a row. Factors such as the suspension of automobile production/shipment by certain manufacturers due to performance test irregularities fueled the drop, with the biggest decline seen with mini vehicles.

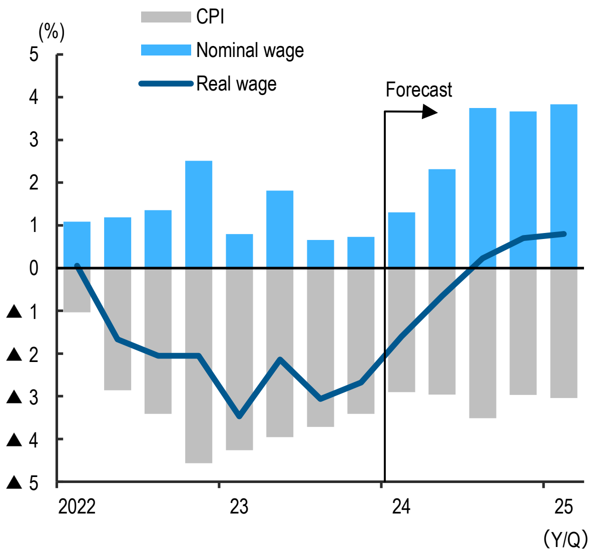
However, these shipment halts are now gradually coming to an end, so car sales are expected to recover soon. Supported by an improved income environment and the wealth effect of rising stock prices, overall personal consumption also looks set to rebound.

Figure 4-1 Scheduled Cash Earnings <YoY>



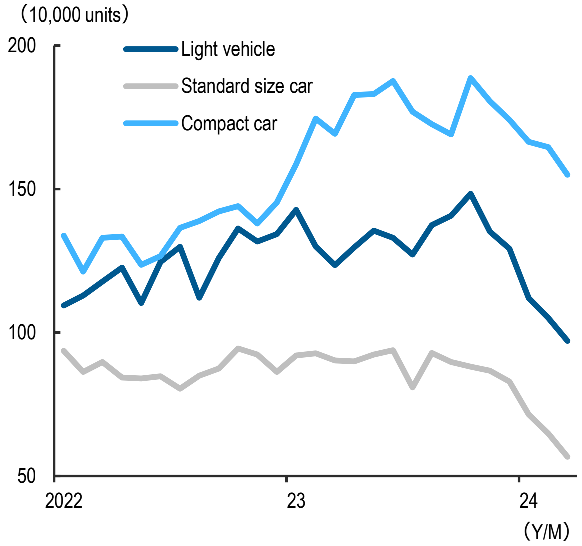
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labour and Welfare.
Note:Adjusted for data fault caused by the replacement of surveyed companies.

Figure 4-2 Real Wages <YoY>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health Labour and Welfare, Ministry of Internal Affairs and Communications.
Note:Gaps have been adjusted for data replacement. Consumer prices are composite excluding imputed rent of owner-occupied houses.

Figure 4-3 New Vehicle Registrations <annualized, seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Japan Automobile Dealers Association, etc.

The Bank of Japan (BOJ) has scrapped its negative interest rate policy

◆ The BOJ's measure of core CPI is steadily slowing

In February, core inflation accelerated from the previous month to 2.8% YoY. In the same month of the previous year, the government introduced measures to mitigate sharp rises in bills for electricity and gas, and the impact of this has significantly narrowed the margin of decline in energy prices. However, The BOJ's measure of core inflation (which excludes fresh food and energy) is steadily slowing. Although inflation in service items was high, that in goods items, particularly food, contracted, due in part to the abating of imported inflationary pressures.

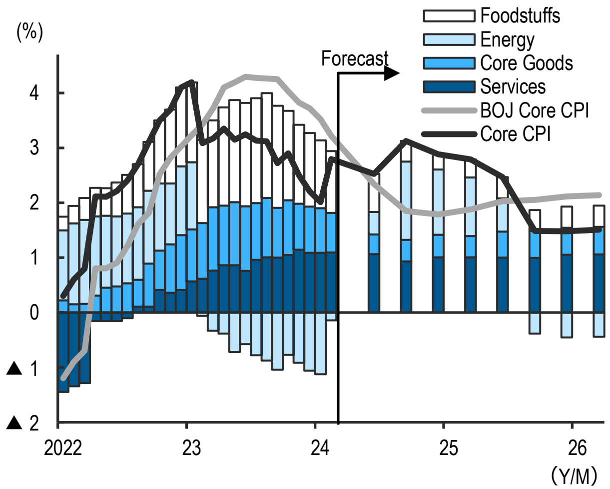
For the time being, the core CPI is expected to keep rising at a pace of above 2%. Moves to pass on higher wages to selling prices will become more widespread, so prices of services will continue to rise. In addition, energy price inflation is expected to increase going into the summer. And estimates indicate that the government's reduction/termination of its measures to ease the pain of rising prices will push up the core CPI by as much as one percentage point or more.

◆ BOJ will continue to gradually raise interest rates going forward

At its March monetary policy meeting, the BOJ ditched its negative interest rate policy, and decided to raise its policy rate target to 0.0-0.1%. In March, long-term interest rates rose at the beginning of the month but then fell back as the BOJ's cautious stance on monetary tightening reinforced expectations that the low interest rate environment would persist.

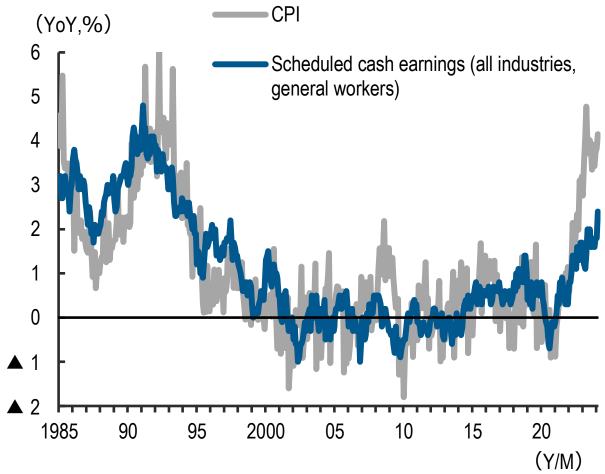
Looking ahead, the BOJ is expected to raise interest rates further at its October meeting once it confirms that wage and price increases are being sustained. Long-term interest rates look set to rise gradually due to policy rate hikes and the recovery in the domestic economy.

Figure 5-1 Consumer Price Index <YoY>



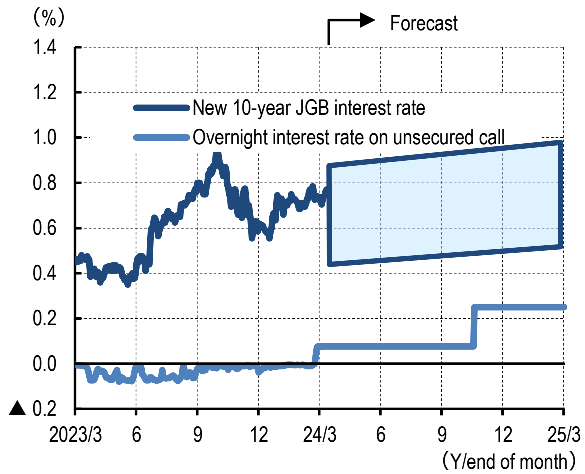
Source: The Japan Research Institute, Ltd. based on the data of Ministry of Internal Affairs and Communications.
Note:The forecast period is for the quarter.

Figure 5-2 Wages and Service Prices



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance,Ministry of Internal Affairs and Communications
Note:Consumer prices are for general services excluding rent
; after April 2020, excluding telecommunication and accommodation costs
; before 1993, predetermined salaries include part-time workers.

Figure 5-3 Outlook for Japan's Main Interest Rates



Source:The Japan Research Institute, Ltd. based on data of NEEDS-FinancialQUEST.

Topic①: Increased costs weigh down on capital investment by SMEs

◆ Capital investment is robust, yet varies by company size

Capital investment is strong. According to the Financial Statements Statistics of Corporations, capital investment in October-December 2023 jumped 10.4% QoQ, a substantial rise. Software investment was especially strong due to such factors as rising labor-saving needs stemming from intensifying labor shortages.

However, the strength of the appetite for capital investment varies depending on the size of the company. Capital investment in FY2023 (cumulative for the period of April-December) increased significantly from the previous year at large companies, but decreased at small and medium-sized enterprises (SMEs). Increased investment costs can be pointed to as a background factor. According to the Cabinet Office's Business Outlook Survey for the January-March quarter, more companies than in typical years cited "cost changes" as a reason for divergence between their capital investment plans and projections for actual investment during the fiscal year (FY23), and this trend was more pronounced at SMEs.

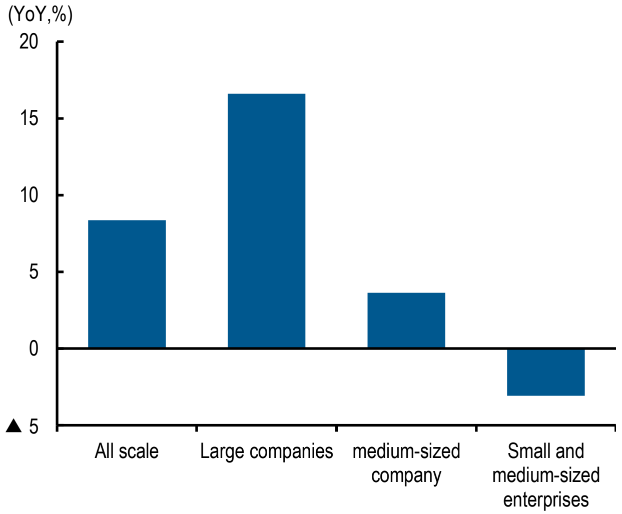
◆ Capital investment by SMEs will increase

Capital investment by SMEs is expected to return to a rising track going forward. Against the backdrop of an easing of imported inflationary pressures, the rise in investment costs slowed. Firms' appetite for investment is also strong, and according to the BOJ's March Tankan Survey, capital investment plans for FY2024 are substantially high compared with typical years in both the manufacturing and non-manufacturing sectors. Notably, demand for software investment for labor-saving and data-related applications is brisk even among SMEs, and this is expected to be a driving force in the future.

Figure 6-1 Capital Investment Amount of Corporate Enterprises <seasonal adjustment>

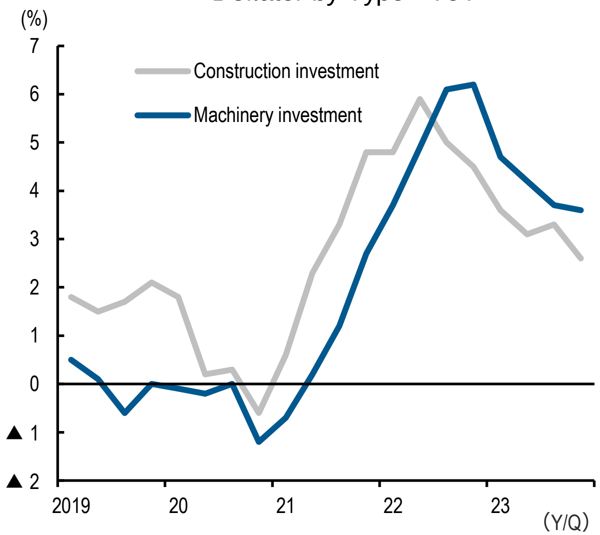
Source:The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note:All industries except finance and insurance. Includes software investment.

Figure 6-2 Capital Investment in FY2023 <cumulative April-December period>



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

Figure 6-3 Fixed Capital Formation Deflator by Type <YoY>



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

Topic②: Impact of rising interest rates on households will vary according to their assets and liabilities

◆ Higher interest rates will improve household finances, especially among the elderly

The BOJ has lifted its negative interest rate policy, raising interest rates for the first time in 17 years. If 2% inflation becomes established and the BOJ embarks on additional rate hikes, interest rates may rise substantially.

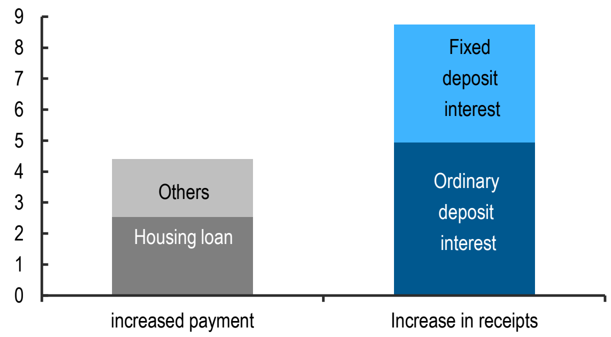
As interest rates go up, households overall are expected to receive more interest than they pay. If market interest rates rise by 2% over five years, the interest payment burden of households as a whole will increase by 4.4 trillion yen per year, while interest income will jump by 8.7 trillion yen per year, meaning that net receipts will be 4.3 trillion yen.

However, the impact will vary significantly depending on households' assets and liabilities. By age group, the benefits will be greater among the elderly. This is due to the fact that young and middle-aged people have a lot of debt such as mortgages, while elderly people have large amounts of deposits. For the average elderly household whose head is 70 years or older, interest income will increase by 140,000 yen per year, which can cover the increased burden of living expenses (57,000 yen) due to 2% inflation.

◆ 40% of the elderly will not benefit

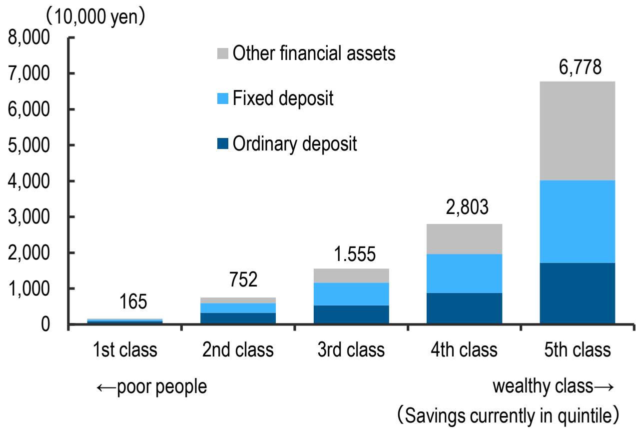
However, there are large disparities in assets among elderly households, and many of them will not benefit from rising interest rates. It is estimated that elderly households will need deposits of at least six million yen for interest income to offset the effect of inflation, yet the savings of 5.94 million elderly households (42% of the total) fall short of this figure. In the future, as rising prices becomes the norm, attention will need to be paid to the possibility of an increase in the number of elderly households finding it difficult to get by.

Figure 7-1 Changes in Household Income and Expenditure due to a 2% Rise in Market Interest Rates



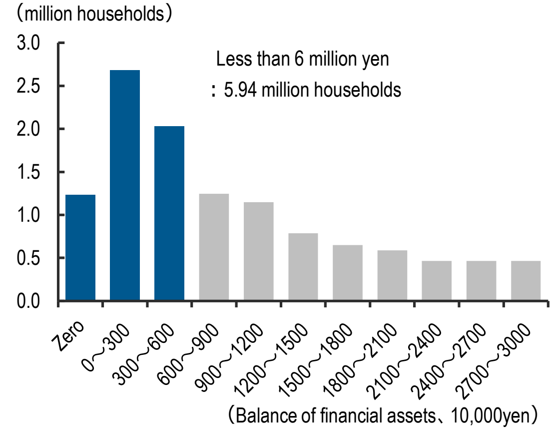
Source:The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, Ministry of Land, Infrastructure, Transport and Tourism.
Note:See below for the calculation method. Nishioka, Kitatsuji (2024)[Monetary policy normalization series ④] Rising interest rates do not benefit 40% of elderly households. Japan Research Institute, Research Focus, No2023 -052

Figure 7-2 Financial Assets Held by Elderly Households <per household>



Source:Ministry of Internal Affairs and Communications.
Note:2022. Households with two or more persons whose head of household is 70 years of age or older.

Figure 7-3 Distribution of Financial Assets of Elderly Households



Source:The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note:2019.Households whose head of household is 70 years of age or older. Households with financial assets of 30 million yen or more are omitted.

The economy will gradually recover, driven by domestic demand

◆ Strong corporate earnings will serve as a launchpad

Growth in January-March may have been negative for the first time in two quarters. The impact of certain automakers' suspensions of vehicle shipments seem to have caused personal consumption and exports to fall.
From April-June onward, the economy is expected to get back to a moderate recovery track, led by domestic demand. Bumper corporate profits will likely lead to a proactive stance on spending among firms, characterized by wage hikes that outpace inflation and an expansion in capital investment.

Thereafter, personal consumption is expected to gradually recover, supported by an improved employment/income environment and the wealth effect of rising stock prices. As the wage hikes agreed during the shunto, which were at the highest level for 33 years, are applied by more and more firms, real wage growth is forecast to enter positive territory in the summer. Wages for non-regular workers, which are less affected by shunto trends, are also expected to rise due to intensifying labor shortages and higher minimum wages.

Capital investment should continue to increase thanks to strong corporate earnings. In addition to stepping up digital investment for labor-saving amid increasingly severe labor shortages, companies are expected to accelerate moves to relocate production back to Japan.

◆ The growth rate for FY2024 will be +0.9%

Real growth is projected to have been +1.4% in FY2023 and to be +0.9% in FY2024 and +1.1% in FY2025. Due to the weak economy in the second half of FY2023, the growth rate is expected to remain in the zero-percent range in FY2024, but it should return to the 1% level in FY2025.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of April 15, 2024)

(%, changes from the previous fiscal year)

	CY2023	CY2024				CY2025				CY2026	FY2023	FY2024	FY2025
	10～12	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3			
	(Actual)	(Projection)									(Projection)		
Real GDP	0.4	▲ 0.4	2.0	1.7	1.4	1.2	1.2	1.1	1.1	1.2	1.4	0.9	1.2
Private Consumption Expenditure	▲ 1.0	▲ 1.1	2.6	2.4	1.6	1.2	0.9	0.8	0.8	0.8	▲ 0.5	1.0	1.1
Housing Investment	▲ 3.9	0.0	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 0.2	▲ 0.3	▲ 0.3	▲ 0.3	1.4	▲ 0.7	▲ 0.2
Business Fixed Investment	8.4	▲ 1.7	2.4	2.3	2.3	2.1	2.3	2.4	2.4	2.4	0.7	2.1	2.3
Private Inventories (percentage points contribution)	(▲ 0.5)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.3)	(▲ 0.2)	(▲ 0.0)
Government Consumption Expenditure	▲ 0.7	0.3	0.2	0.1	0.1	0.0	0.2	0.2	▲ 0.3	0.0	0.5	0.1	0.1
Public Investment	▲ 3.0	1.2	1.2	1.0	0.8	0.8	0.8	0.4	0.4	0.4	2.7	0.3	0.7
Net Exports (percentage points contribution)	(0.8)	(0.4)	(0.0)	(▲ 0.0)	(0.1)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(1.6)	(0.2)	(0.2)
Exports of Goods and Services	10.7	▲ 0.4	1.8	1.7	2.2	2.7	2.9	3.1	3.4	3.5	4.3	2.6	2.9
Imports of Goods and Services	6.9	▲ 2.1	1.6	1.7	1.9	1.9	1.9	1.9	2.1	2.0	▲ 2.6	1.8	1.9

(% changes from the same quarter of the previous year) (% changes from the previous fiscal year)

	CY2023 10～12	CY2024 1～3	4～6	7～9	10～12	CY2025 1～3	4～6	7～9	10～12	CY2026 1～3	FY2023	FY2024	FY2025
Nominal GDP	5.1	4.2	2.4	3.6	3.6	3.4	3.0	2.7	2.5	2.7	5.6	3.2	2.7
GDP deflator	3.9	3.7	2.6	2.6	2.5	1.7	1.6	1.5	1.4	1.5	4.1	2.4	1.5
Consumer Price Index (excluding fresh food)	2.5	2.4	2.5	3.1	2.9	2.8	2.5	1.5	1.5	1.5	2.8	2.8	1.7
Unemployment Rate (%)	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.5	2.4	2.3
Exchange Rates (JY/US$)	148	148	145	143	140	138	136	134	132	130	145	142	133
Import Price of Crude Oil (US$/barrel)	93	83	87	88	87	85	82	80	79	77	86	87	80

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.