

# Monthly Report of Prospects for Japan's Economy

June 2012

Macro Economic Research Centre  
Economics Department



The Japan Research Institute, Limited

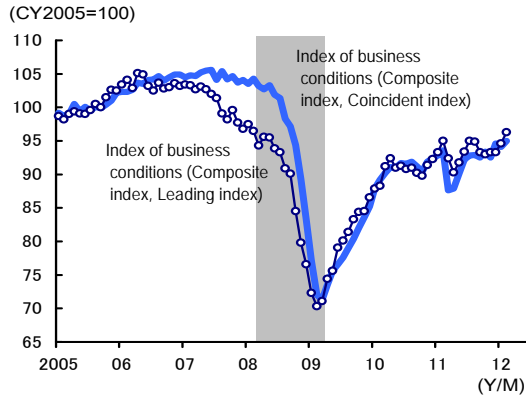
<http://www.jri.co.jp/thinktank/research/>

This report is the English version of the May 2012 issue of the original Japanese version.

# The general situation of Japan's economy – Economic activity has been partly picking up

Figure 1-1 Economic Activity

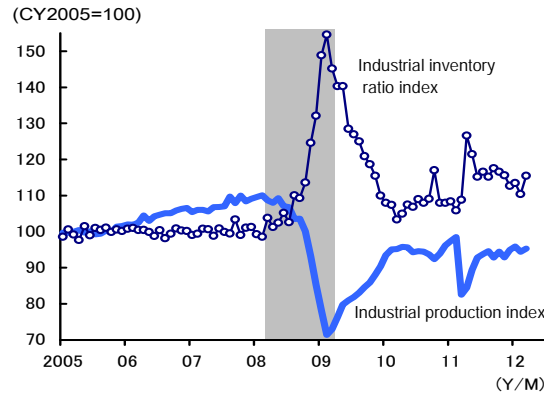
Economic activity is on a recovery trend in total, as the reconstruction from the disaster advances.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

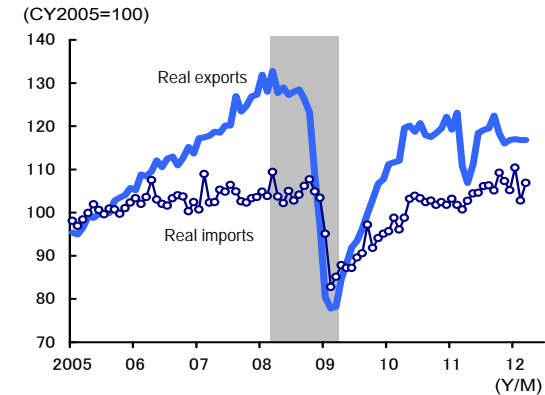
Industrial production is on a moderate recovery trend. The inventory ratio is still above the pre-disaster level.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

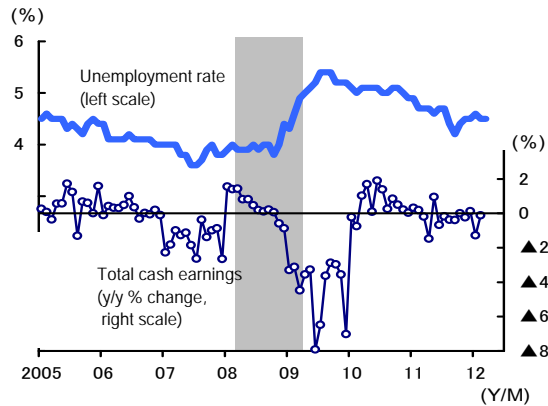
Exports have flattened out in spite of the increase in exports to the US. Imports stay at a higher level.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is flat. Total cash earnings are at almost the same level as a year earlier.

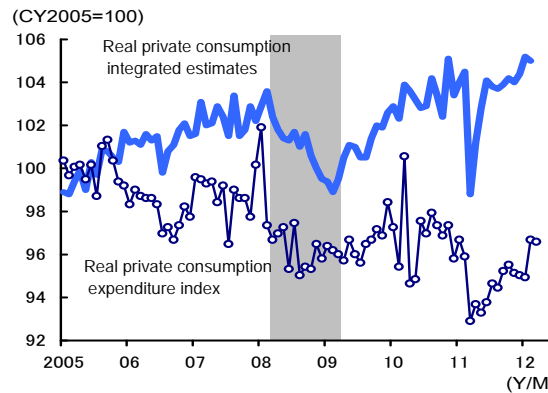


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

\* The shaded area indicates the phase of recession.

Figure 1-5 The Household Sector

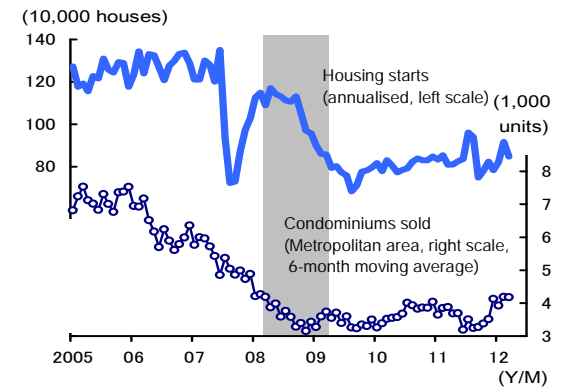
Firm as a whole, partly supported by the government measures for the purchase of eco-cars.



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

Figure 1-6 Housing Investment

Housing starts are at a low level. Condominium sales are on a recovery trend.



Source: The Ministry of Land, Infrastructure and Transport, Real Estate Economic Institute Co., Ltd..

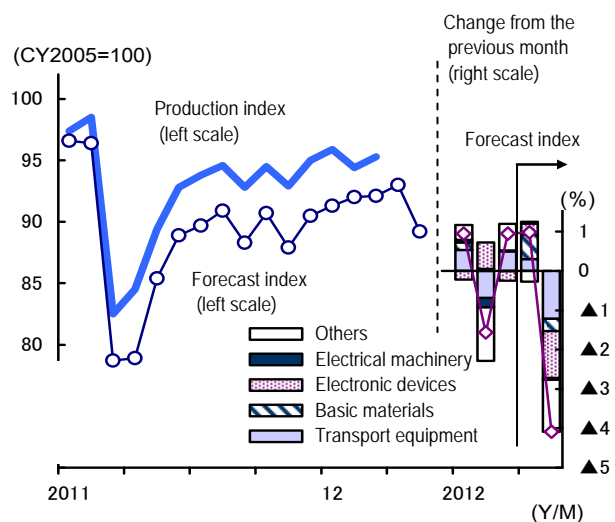
Monthly Report of Prospects for Japan's Economy June 2012  
The Japan Research Institute, Limited

## Industrial production increased again, yet at a slower pace than anticipated

The industrial production index increased by 1.3 per cent over the previous month in March, for the first time in two months. Viewed by industry, the production of automobiles has risen, due to the support measures of the government for the purchase of eco-cars, and solid car exports to the US. The production of basic materials such as iron and steel and nonferrous metals has also risen, reflecting heightened reconstruction activity from the earthquake and tsunami disaster. However, it is expected that the recovery trend in industrial production since the disaster last year will take a breather hereafter, as the production forecast indices for May show a decline in a wide range of industries.

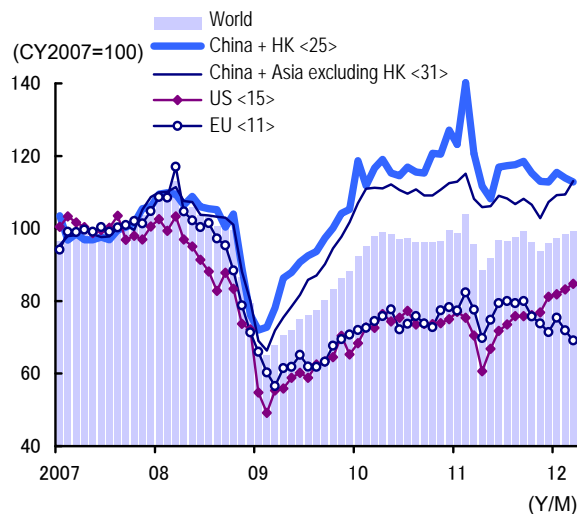
Exports have been flat in total. Viewed by region, exports to the US continue a solid pace, against the background of the moderate recovery in the US economy. On the other hand, exports to China, which has the largest share in Japan's total exports, have flattened out and have shown no sign of improvement. Imports have accelerated their increasing trend, due to a rapid increase in imports of crude oil and liquefied natural gas (LNG) for thermal power generation. As a result, the trade balance continues its deficit tendency.

Figure 2-1 Industrial Production and Production Forecast by Sector  
<seasonally adjusted>



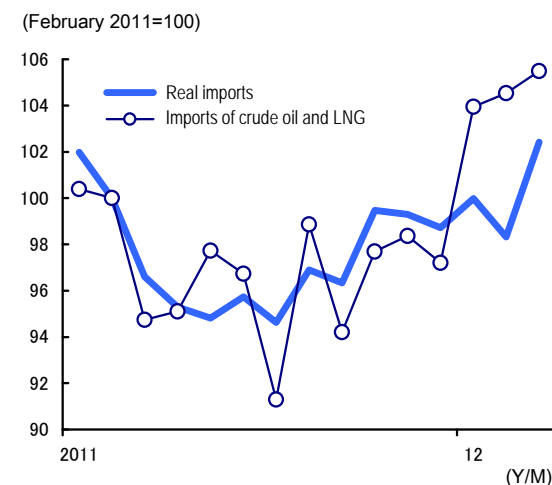
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Economy, Trade and Industry.

Figure 2-2 Real Exports by Region  
<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 FY2010.

Figure 2-3 Real Imports  
<seasonally adjusted>



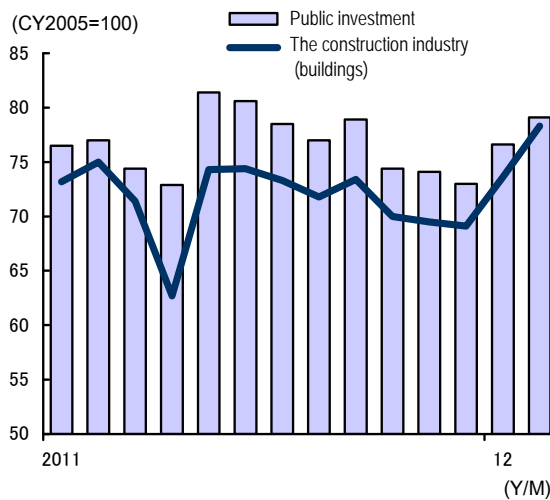
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.

## Reconstruction activity from the disaster has been accelerating

Restoration and reconstruction activity in the disaster-hit areas has been livening up, due to the effects of the related budgets which had been drawn up by the government. The index of supply for public investment in the indices of all industry supply, which show which sort of demand is met by the supply of a certain item among goods and services in various industries, increased for two consecutive months, reflecting the increase in supply of buildings in the construction industry.

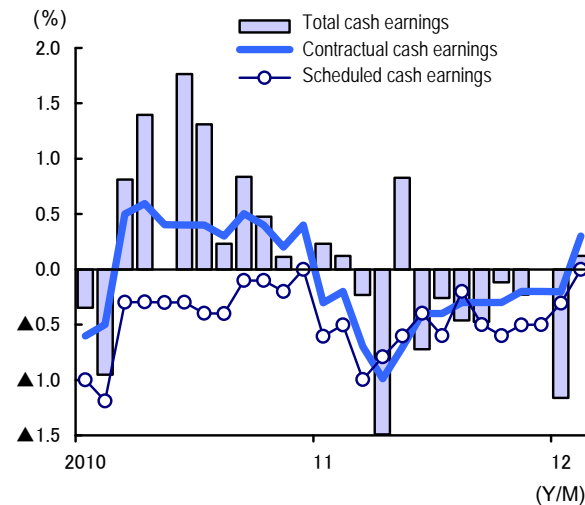
In the household sector, the diffusion indices for current business conditions in the private consumption-related industries have improved in March, after corrections to the softened stock prices and the strong yen had taken place. Also, the year-on-year change in total cash earnings has turned positive. However, the extent of improvement in private consumption expenditure varies with products on sale, as the environments surrounding households advance moderately. Automobiles have been doing well, supported by the government measures such as subsidies and tax cuts for the purchase of eco-cars. On the other hand, household electrical appliances have been weakening, led by TV sets which have suffered from the rapid reactionary decline after the rushed increase before the changeover to digital broadcasting last summer.

Figure 3-1 Indices of All Industry Supply  
<seasonally adjusted>



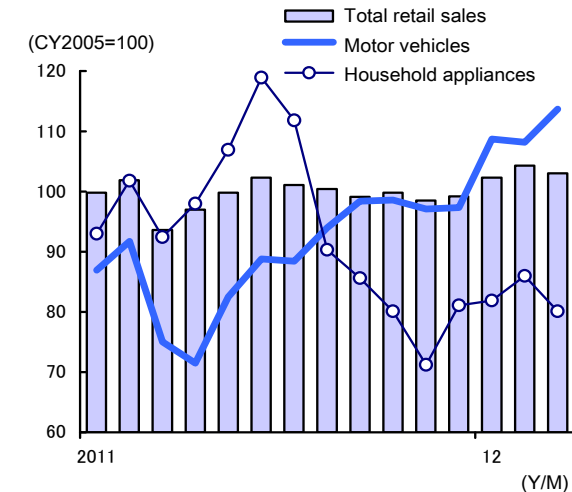
Source: The Ministry of Economy, Trade and Industry.

Figure 3-2 Total Cash Earnings  
<year-on-year % change>



Source: The Ministry of Health, Labour and Welfare.

Figure 3-3 Indices of Retail Sales Value  
<seasonally adjusted>



Source: The Ministry of Economy, Trade and Industry.

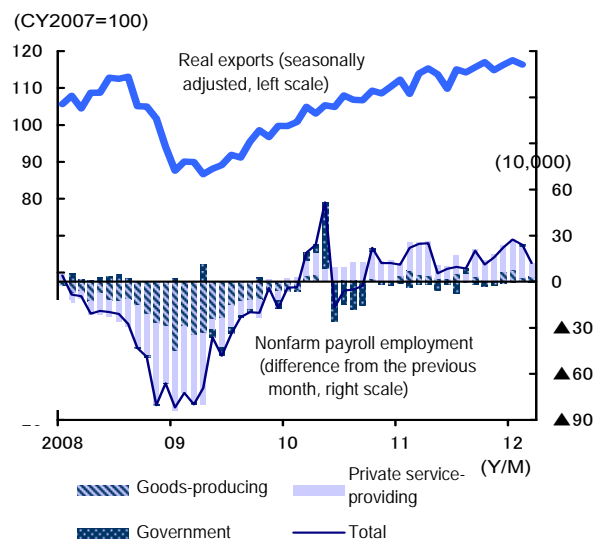
## The effect of the slowdown in overseas economies would be limited

It is likely that the US economy will maintain its recovery trend, as an increase in exports bolsters economic activity and employment continues a moderate increasing tendency. It is predicted that the Chinese economy will be supported by its domestic demand as inflationary pressure tends to ease, although the pace of increase in exports is tending to slow down.

On the other hand, European economies as a whole are projected to see a slightly negative figure in the real GDP change rate through the first half of this year, due to austerity budgets, worsening employment and income environments, and so on. However, the negative effect of the deterioration in European economies on Japan's economy would be limited, because the share of exports to the EU in Japan's total exports is smaller than that of exports to the US or China on a value basis. Also, as long as European economies do not fall into a deep recession, a considerable deceleration in the Chinese economy will be able to be avoided. Thus, the indirect downward pressure of the slowdown in China's exports to the EU, which have a larger share viewed by destination, on Japan's exports to China would be limited.

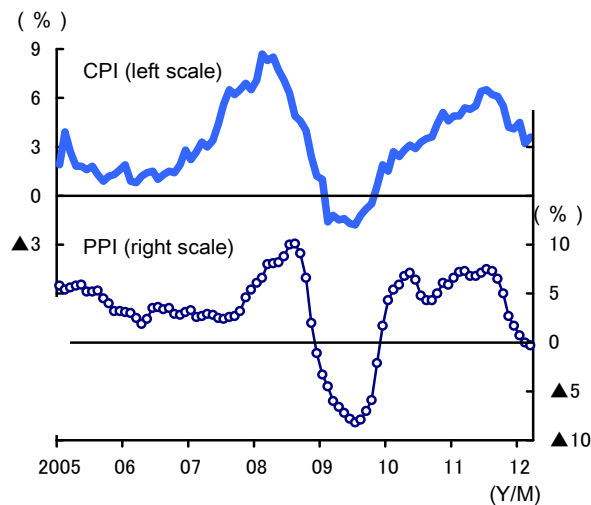
As it is unlikely that the US and Chinese economy will falter, the effect of the slowdown in overseas economies on Japan's exports and production will be limited.

Figure 4-1 Exports and Employment in the US



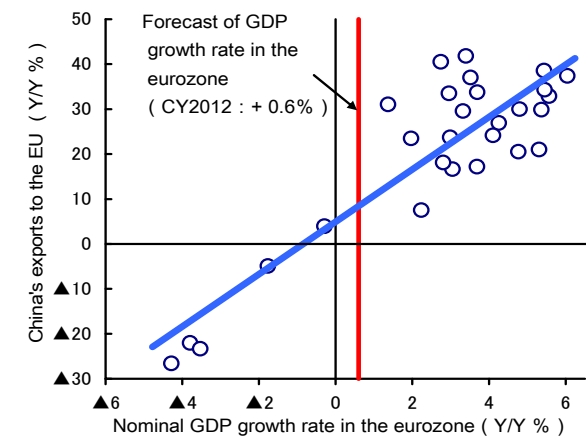
Source: US Census Bureau, US Department of Labor.

Figure 4-2 China's CPI and PPI <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The National Bureau of Statistics of China.

Figure 4-3 GDP Growth Rate in the Eurozone and China's Exports to the EU <year-on-year % change>



Source: Eurostat, Statistics of China Customs.

Monthly Report of Prospects for Japan's Economy June 2012  
The Japan Research Institute, Limited

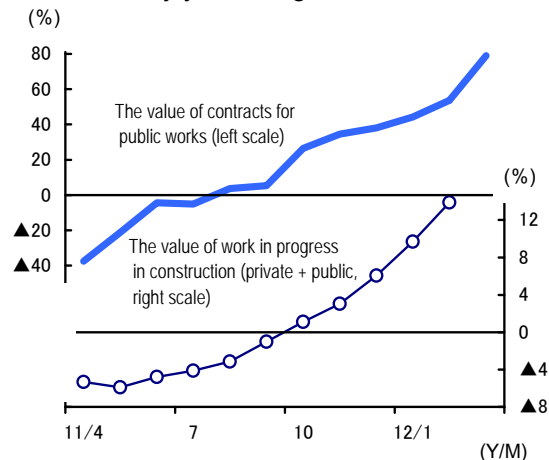
## Reconstruction demand would continue to materialise in earnest

The pace of increase in the value of work in progress in construction in the disaster stricken three prefectures (Iwate, Miyagi, and Fukushima) appears to be accelerating. The value of contracts for public works, which is considered to be a leading indicator for public investment, also continues to expand. Accordingly, it is expected that reconstruction demand will materialise in earnest hereafter and boost economic activity.

Thus far, the government has budgeted a total of about 18.5 trillion yen related to restoration and reconstruction from the disaster, about 11.5 trillion yen of which is estimated to be counted as the amount which can boost the real GDP growth rate directly as "reconstruction demand". It is assumed that about 8.2 trillion yen of "reconstruction demand" in the third supplementary budget in FY2011 and the budget in FY2012 will materialise from now on. Based on the JRI macro model simulation, which was made on the basis of, for example, the pattern in the value of contracts for public works, which is a leading indicator for public investment, it is projected that the materialisation of about 8.2 trillion yen of "reconstruction demand" in the budgets will raise the real GDP growth rate in FY2012 by 1.2 percentage points.

However, an insufficiency of workers for public works in the disaster stricken areas has been a bottleneck to the restoration and reconstruction. It is worrisome that this obstacle could delay the materialisation of reconstruction demand in earnest.

Figure 5-1 Construction Investment in the Disaster Stricken 3 Prefectures  
<y/y % change of the FY sum total>



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

Notes: 3 prefectures = Iwate, Miyagi, Fukushima.

Figure 5-2 Estimate of Reconstruction Demand

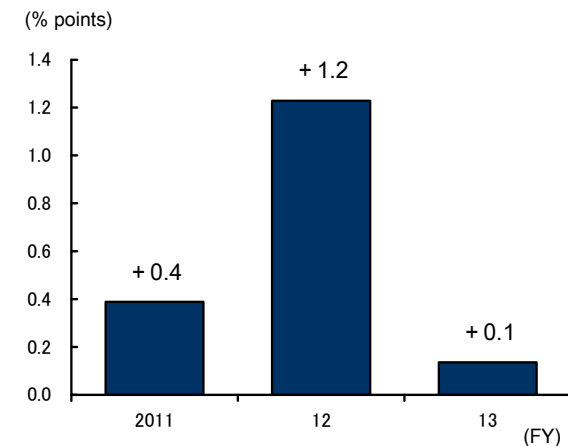
(Trillion yen)

	The first supplementary budget in FY2011	The second supplementary budget in FY2011	The third supplementary budget in FY2011	The fourth supplementary budget in FY2011	The draft budget for FY2012	Total
Government consumption expenditure	0.5	0.0	0.8	Note	0.7	2.0
Public investment	1.3	0.0	3.4	Note	0.9	5.6
Grants, reserves, etc.	0.1	1.3	1.4	Note	0.9	3.8
<b>Total</b>	<b>1.9</b>	<b>1.4</b>	<b>5.6</b>	<b>Note</b>	<b>2.6</b>	<b>11.5</b>

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

Note: The fourth supplementary budget is not related to reconstruction.

Figure 5-3 The Boosting Effect of Reconstruction Demand on Real GDP  
<macro model simulation>



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

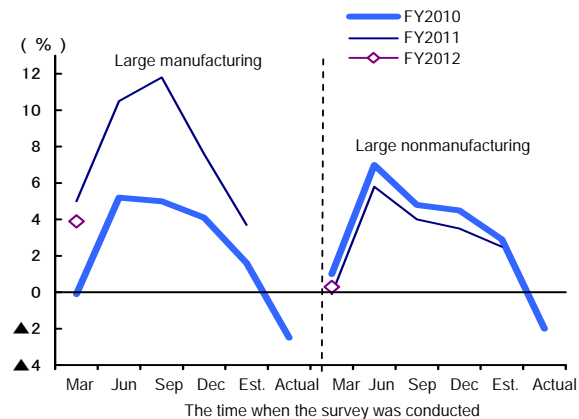
Monthly Report of Prospects for Japan's Economy June 2012  
The Japan Research Institute, Limited

## Persistent downward pressure on corporate profits

Based on the Tankan Survey, cautious attitudes of Japanese enterprises have been seen not only in the diffusion index for business conditions but also in their plans of business fixed investment. In the March 2012 Tankan Survey, large manufacturing forecast that business fixed investment in FY2012 would grow at a slower pace than in FY2011. Also, large nonmanufacturing forecast that investment in FY2012 would stay at almost the same level as in FY2011.

As for those cautious attitudes of enterprises, it can be pointed out that the continued strong yen is one of the backgrounds. The yen / dollar exchange rate, where correction to its highly appreciated level had taken place since the start of this year, has risen again to the level beyond the break-even exchange rate, reflecting heightened anxiety over the European debt crisis and uncertainties surrounding the prospects for the US economy. It is considered that the continued strong yen reduces corporate profits in total ultimately through a subsequent decrease in export quantity and negative ripple effects between industries, although a certain sort of industries do have exchange-margin profits due to the price effect. Based on the JRI macro model simulation, it is calculated that current profits of Japanese non-financial enterprises would decline by 3.9 per cent in FY2012 and 6.8 per cent in FY2013, if the yen appreciates by a further 10 per cent against the US dollar from the base line (main scenario) exchange rate in FY2012 (83 yen / dollar).

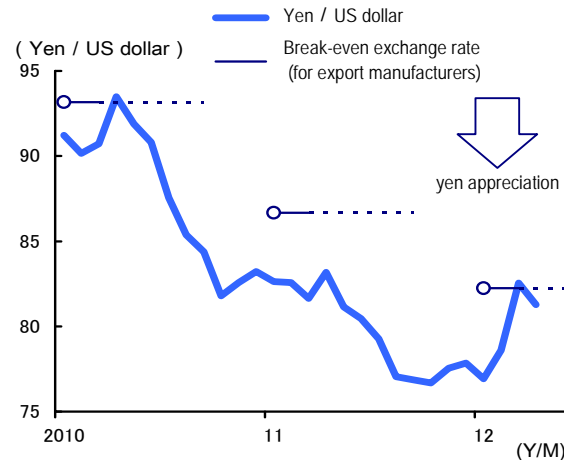
Figure 6-1 Revisions to Plan of Business  
Fixed Investment in BOJ Tankan  
<large enterprises, FY/FY % change >



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

Note: Including software investment, and excluding land purchase expenses.

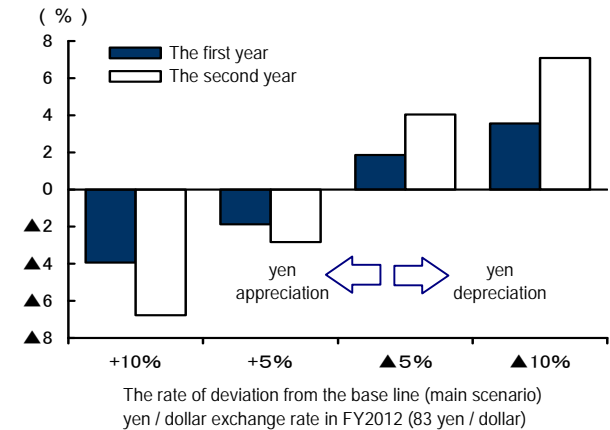
Figure 6-2 Yen / US Dollar Exchange Rate  
and Break-even Exchange Rate



Source: Bloomberg L.P., The Cabinet Office.

Note: The mark "O" indicates the time when the survey was conducted.

Figure 6-3 Estimate of Effect of Change  
in Yen Exchange rate  
on Corporate Profits



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

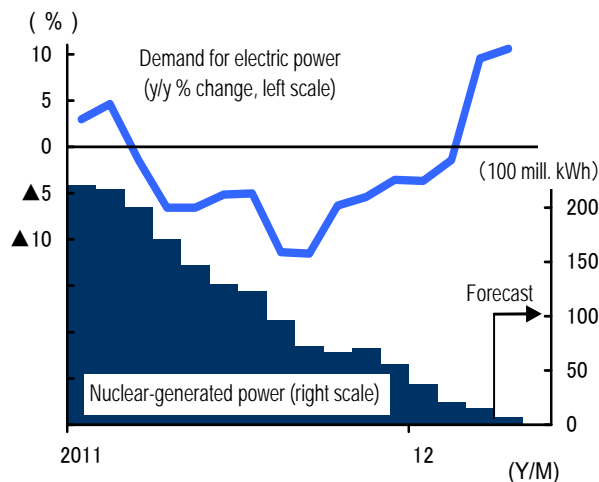
Monthly Report of Prospects for Japan's Economy June 2012  
The Japan Research Institute, Limited

# The shortage of electric power supply is worrisome especially in the Kansai region

It is worryingly estimated that the district of The Kansai Electric Power Co., Inc., which has a high dependence on nuclear power generation, could suffer from a severe electric power shortage, if the currently stopped nuclear power plants are not restarted and this summer has a heat wave similar to that in 2010. In this situation, the government referred to the possibility of the plan for rolling blackouts in the district in preparation for the unexpected. If the electric power shortage is realised and planned rolling blackouts are enforced, electricity savings and cuts in electric power could curb the production activity in the region.

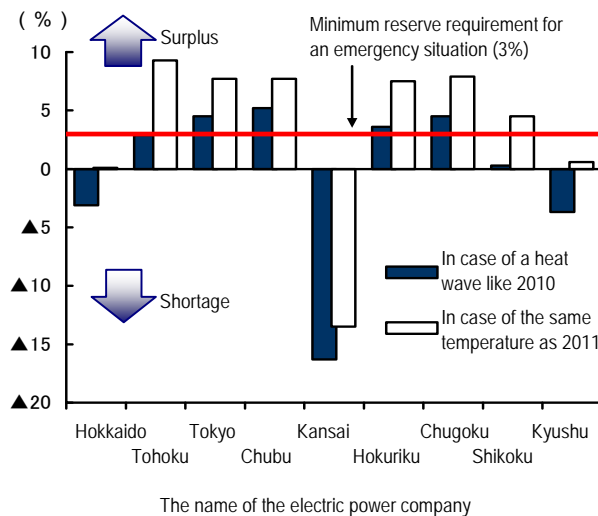
It is considered that the shortage of electric power supply will have more significant negative effects on the Kansai region, in which manufacturing has a larger share in the total, than on the Kanto (Metropolitan) region. The level of production activity in the Kansai region has declined due to the slowdown in emerging economies and the strong yen. In addition, it is difficult for the benefits stemming from restoration and reconstruction from the earthquake and tsunami disaster to reach the region, in contrast to the Tohoku and Kanto regions. Therefore, it is more worrisome that tight electricity supply could curb the economic activity in the Kansai region further.

Figure 7-1 Demand for Electric Power and Nuclear-generated Power



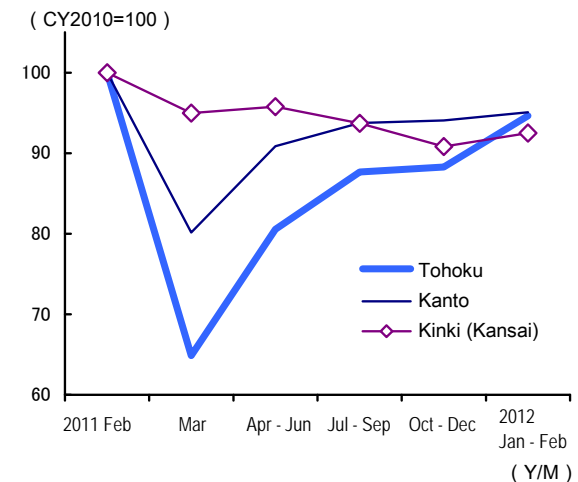
Source: The Japan Research Institute, Ltd. based on the data of The Federation of Electric Power Companies of Japan.

Figure 7-2 Forecast of Supply-demand Situation in Electric Power This Summer by Each Electric Power Company



Source: The Japan Research Institute, Ltd. based on the data of The National Policy Unit, each electric power company.

Figure 7-3 Industrial Production Index by Region <seasonally adjusted>



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

Monthly Report of Prospects for Japan's Economy June 2012  
The Japan Research Institute, Limited



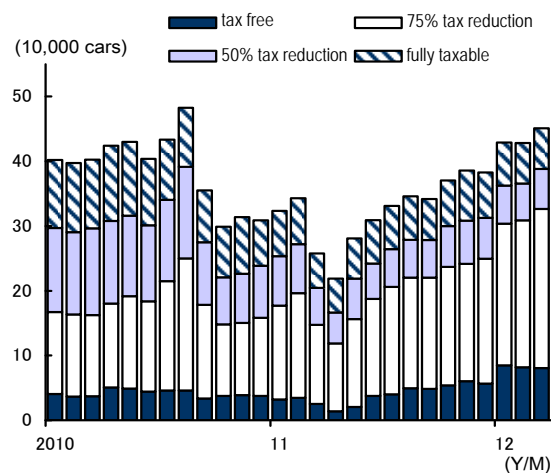
## Private consumption expenditure is expected to maintain its moderate increasing trend

Automobile sales continue an increasing trend, supported by government measures such as restored subsidies and extended tax cuts for the purchase of eco-cars. Reflecting the favourable move, the Japan Automobile Manufacturers Association Inc. released their forecast in March that domestic demand for automobiles in 2012 would likely top the 4.8 million car mark, the second consecutive fiscal yearly increase. Therefore, it is probable that the increase in automobile sales will contribute to supporting private consumption expenditure for the time being.

In addition, it is predicted that income environments will improve, as industrial production turns positive year-on-year, reflecting the materialisation in earnest of demand stemming from reconstruction from the earthquake and tsunami disaster. Also, consumer sentiment seems to have recovered almost fully from the cooling down caused by the disaster.

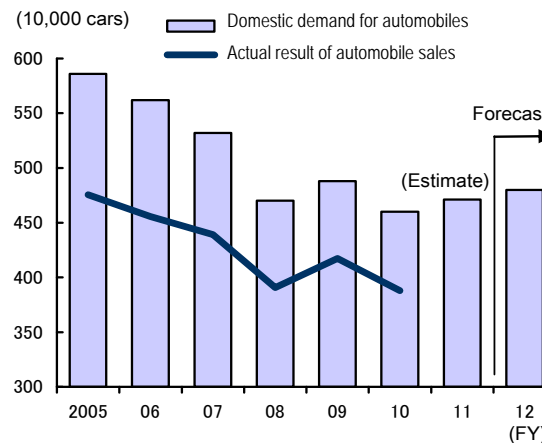
Judging from the above mentioned favourable elements, it is projected that private consumption expenditure will continue its increasing trend, although the pace of increase will be moderate.

Figure 8-1 Automobile Sales by Type of Tax Reduction <seasonally adjusted>



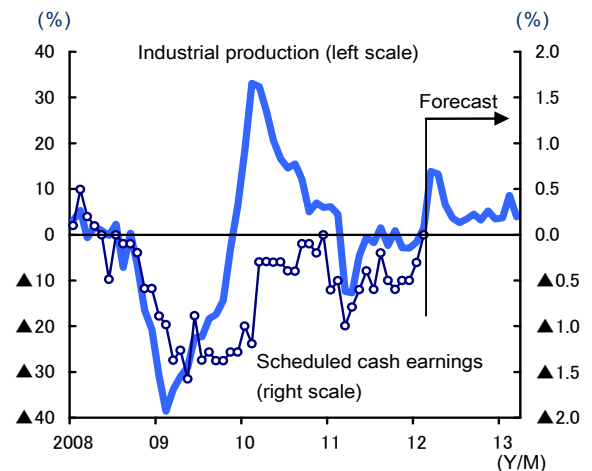
Source: The Japan Research Institute, Ltd. based on the data of The Japan Automobile Manufacturers Association Inc..

Figure 8-2 Forecast of Domestic Demand for Automobiles and Actual Automobile Sales



Source: The Japan Research Institute, Ltd. based on the data of The Japan Automobile Manufacturers Association Inc., Japan Automobile Dealers Association, Japan Mini Vehicles Association.

Figure 8-3 Industrial Production and Scheduled Cash Earnings <year-on-year % change>



Source: The Ministry of Economy, Trade and Industry, The Ministry of Health, Labour and Welfare.

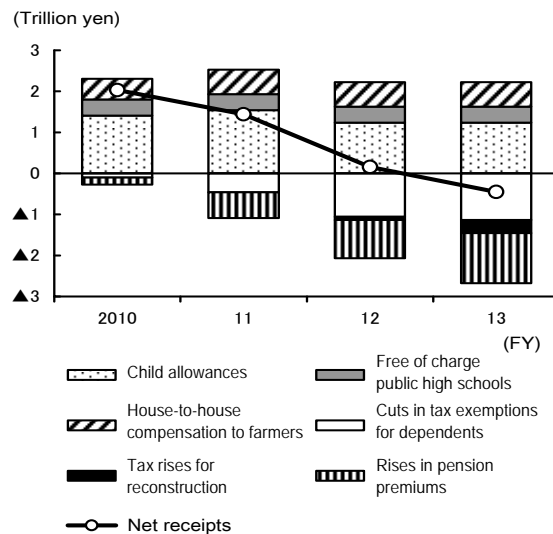
## The increase in the financial burden on households could weigh on consumption

It is highly likely that the financial burden on households will rise because the government is expected to have to increase revenues for the reconstruction from the disaster as well as the rebuilding of public finance.

As the period during which the income tax is raised for reconstruction was decided to be 25 years, the financial burden on households per year will be light. However, the abolition of tax exemptions for dependents which will be used as the revenue for child allowances, and a rise in pension premiums will be a heavy financial burden on households. As a result, net benefit to households in FY2012 is expected to decrease by about one trillion yen from the previous fiscal year. The decrease in net benefit is predicted to be a downswing factor to private consumption expenditure through a decline in disposable income of households. The JRI macro economic model simulation shows that a decrease in disposable income by one trillion yen will lower private consumption expenditure ultimately by 700 billion yen.

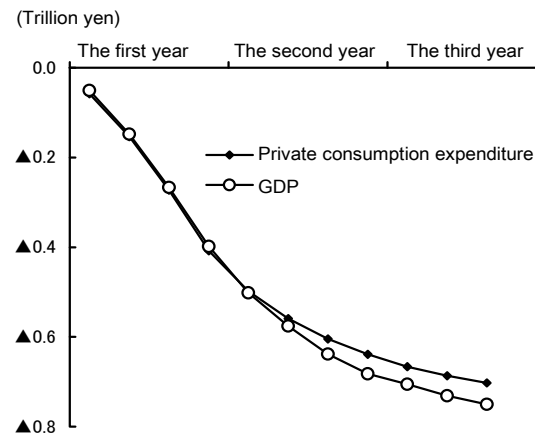
Meanwhile, the government and the DPJ decided that the consumption tax will be raised to 8 per cent in April 2014, and submitted the related bills to the Diet. Due to this tax rise, it is likely that a rushed increase in demand for housing and durable consumer goods in the main will boost GDP growth in the second half of FY2013 considerably. On the other hand, it is predicted that an increase in prices caused by the rise in the consumption tax will lower private consumption expenditure in real terms through a decline in the purchasing power of households.

Figure 9-1 Financial Burden on and Benefit to Households



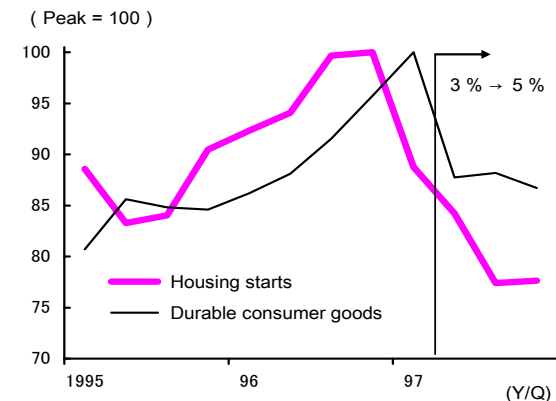
Source: The Japan Research Institute.

Figure 9-2 The Effect of Decrease in Disposable Income by One Trillion Yen <annualised> <macro economic simulation>



Source: The Japan Research Institute.

Figure 9-3 Household Expenditure Before and After the Rise in Consumption Tax <1995-1997>



Source: The Cabinet Office, The Ministry of Land, Infrastructure and Transport.

Monthly Report of Prospects for Japan's Economy June 2012  
The Japan Research Institute, Limited

## Prospects for Japan's economy - Projected real GDP change; 2.2% in FY2012 and 1.7% in FY2013

(1) Japan's real GDP grew by 4.1 per cent in the January-March quarter this year on a seasonally adjusted, annualised percentage change from the previous quarter basis (the first preliminary estimates). This higher growth rate was boosted by a materialising in earnest of demand stemming from restoration and reconstruction from the earthquake and tsunami disaster shown in the increase in public investment, a favourable effect of the supporting measures of the government for the purchase of eco-cars on private consumption expenditure, and so on.

(2) In fiscal year 2012, it is predicted that the following three factors will have positive effects on economic activity:

- 1) An increase in public demand and housing investment due to a materialising in earnest of reconstruction demand.
- 2) A firm trend of private consumption expenditure because of the supporting measures for the purchase of eco-cars and solid income environments.
- 3) A moderate acceleration in the increasing tendency in exports against the background of the solid world economy.

At the same time, it is expected that the following elements will weigh on economic activity:

- 1) Net exports are expected to stagnate through the first half of FY2012, reflecting unfavourable moves such as a slowdown in Asian economies.
- 2) Business fixed investment is likely to flatten out due to continued severe environments surrounding corporate profits, which have been exacerbated by the move that the exchange rates of the yen have risen again.

(3) In fiscal year 2013, it is projected that a rushed increase in demand for housing and durable consumer goods will boost GDP growth in the second half of FY2013 considerably, before a rise in the consumption tax which is expected in April 2014.

(4) On the other hand, it should be noted that there are downside risks to the economy such as a lag in restoration and reconstruction activity from the disaster, further tightness of the supply of electric power, a worsening of the European debt crisis, and so on.

(5) As for the Consumer Price Index excluding fresh food (the core CPI), the deflationary pressure will persist, as shown in the declining trend in prices of household appliances and furniture, although energy-related prices are expected to rise.

Figure 11 Projections for GDP Growth and Main Indicators of Japan ( as of May 17, 2012 )

(seasonally adjusted, annualised % changes from the previous quarter)

	CY2012				CY2013				CY2014	FY2011	FY2012	FY2013
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)	(Projection)			(Projection)				(Projection)	(Actual)	(Projection)	
Real GDP	4.1	1.5	1.7	1.4	1.3	1.2	1.3	2.8	4.6	▲ 0.0	2.2	1.7
Private Consumption Expenditure	4.4	0.4	1.0	0.5	0.6	0.7	0.9	3.2	6.8	1.1	1.8	1.4
Housing Investment	▲ 6.1	9.6	12.4	6.6	1.3	1.3	8.5	8.7	▲ 8.3	3.6	5.5	4.2
Business Fixed Investment	▲ 14.8	4.2	2.6	2.8	3.0	3.1	3.3	3.4	4.2	0.2	1.6	3.2
Private Inventories (percentage points contribution)	( 1.7)	( 0.2)	( 0.1)	( 0.1)	( 0.1)	( 0.1)	( 0.0)	( 0.0)	( 0.0)	(▲ 0.4)	( 0.3)	( 0.1)
Government Consumption Expenditure	2.8	0.5	0.4	0.4	0.4	0.3	0.4	0.5	0.7	1.9	1.1	0.4
Public Investment	23.6	8.0	4.5	2.1	1.2	▲ 4.7	▲ 7.9	▲ 2.4	▲ 1.0	3.9	6.8	▲ 2.6
Net Exports (percentage points contribution)	( 0.5)	(▲ 0.4)	(▲ 0.1)	( 0.1)	( 0.2)	( 0.2)	( 0.3)	( 0.1)	( 0.0)	(▲ 1.0)	(▲ 0.2)	( 0.2)
Exports of Goods and Services	12.3	0.9	3.0	3.8	3.9	4.3	4.5	4.8	4.8	▲ 1.4	3.8	4.2
Imports of Goods and Services	8.0	3.0	3.0	2.8	2.6	2.5	2.5	3.8	4.3	5.3	4.6	2.9
(% changes from the same quarter of the previous year)												
Real GDP	2.7	3.2	1.9	2.1	1.6	1.3	1.3	1.6	2.5	▲ 0.0	2.2	1.7
Nominal GDP	1.4	2.0	1.1	1.5	1.0	0.9	0.9	1.2	2.3	▲ 1.9	1.4	1.4
GDP deflator	▲ 1.2	▲ 1.1	▲ 0.9	▲ 0.6	▲ 0.5	▲ 0.4	▲ 0.4	▲ 0.4	▲ 0.1	▲ 1.9	▲ 0.8	▲ 0.3
Consumer Price Index (excluding fresh food)	0.1	▲ 0.1	▲ 0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.1
Industrial Production Index	4.6	7.6	3.5	3.9	5.4	4.7	2.8	1.6	2.0	▲ 1.0	5.1	2.7
Unemployment Rate (%)	4.6	4.5	4.5	4.4	4.3	4.2	4.2	4.1	4.1	4.5	4.4	4.2
Current Account Balances (trillion JY)	1.84	0.76	1.13	0.24	1.60	1.14	2.01	1.10	2.37	7.41	3.72	6.63
Share of Nominal GDP (%)	1.6	0.7	1.0	0.2	1.4	1.0	1.7	0.9	2.0	1.6	0.8	1.4
Exchange Rates (JY/US\$)	79	81	82	82	82	83	85	87	90	79	82	86
Import Price of Crude Oil (US\$/barrel)	116	123	122	122	122	122	122	122	122	114	122	122

Source: The Cabinet Office; The Ministry of Internal Affairs and Communications; The Ministry of Economy, Trade and Industry; The Ministry of Finance.

The projection figures are based on those of The Japan Research Institute, Ltd.

Note 1: "▲" indicates minus.

2: It is assumed that the consumption tax will be raised from 5% to 8% in April 2014.

3: The assumptions on the real GDP growth rates in CY2012 in major overseas economies: the US 2.2%, the euro area ▲ 0.4%, China 8.5%.