

Monthly Report of Prospects for Japan's Economy

July 2017

Macro Economic Research Centre
Economics Department



The Japan Research Institute, Limited

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

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The general situation of Japan's economy – Economic activity continues its mild recovery trend

Figure 1-1 Economic Activity

The leading index rose for 2 months running, due to an improvement in consumer sentiment and an increase in housing starts.

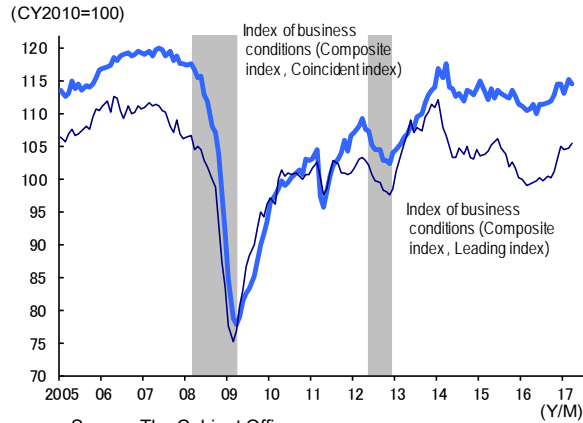


Figure 1-2 The Corporate Sector

The production index rose, for the first time in 2 months, to a level above those in the increasing phase before the rise in the consumption tax rate in 2014.

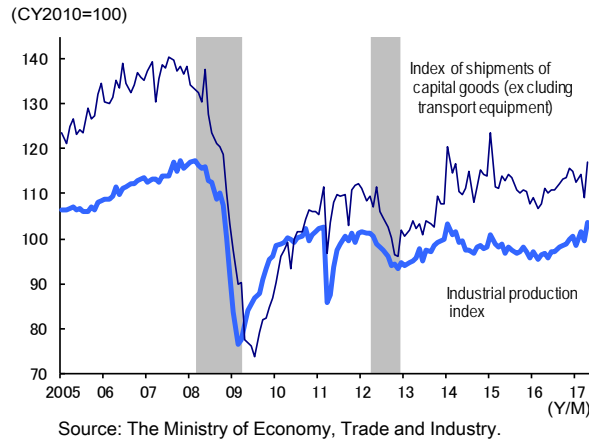


Figure 1-3 Overseas Demand

Exports, especially those to ASEAN countries, took a breather. Imports rose for the second consecutive month.

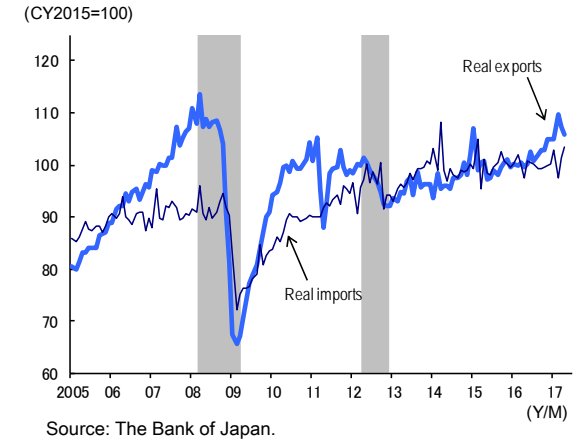
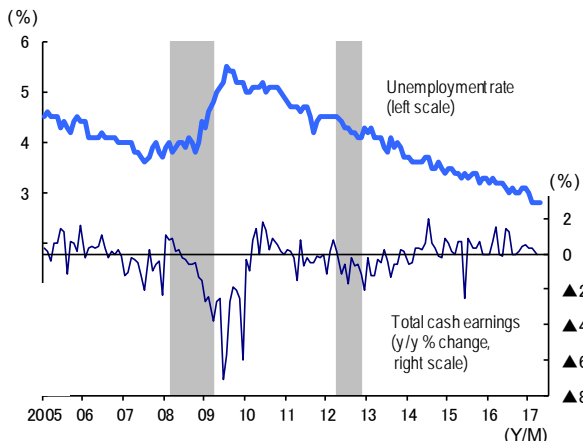


Figure 1-4 Employment and Income

The unemployment rate is at its lowest level since June 1994. Total cash earnings have flattened out.



* The shaded area indicates the phase of recession.

Figure 1-5 The Household Sector

Household consumption expenditure showed signs of mild recovery. Housing starts increased, especially houses for rent and in which the owners will reside.

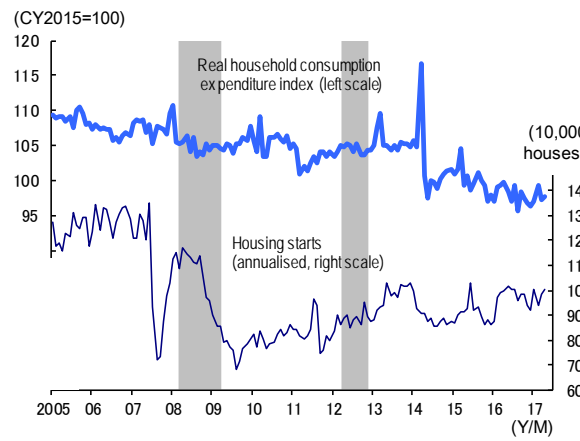
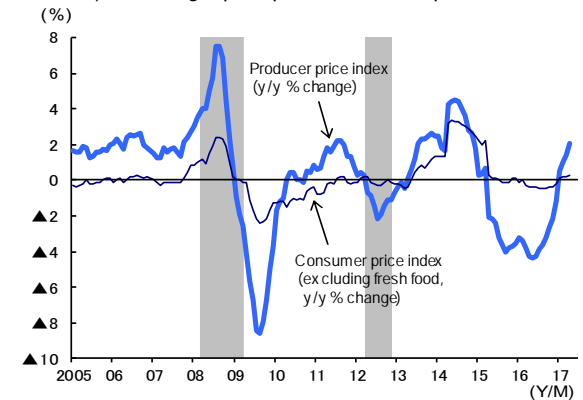


Figure 1-6 Prices

Both producer prices and core consumer prices continue to increase year-on-year (slightly in the latter), reflecting a pickup in the crude oil price.



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Corporate activities continue to pick up, as the household sector shows signs of recovery

◆ Economic activity has picked up mildly

Japan's economic activity continues to be on a mild recovery trend. This is shown also in the national accounts. Namely, Japan's real GDP in the January-March period this year grew by 1.0 per cent on an annualised quarter-on-quarter change basis (the second preliminary estimates), a positive growth for the fifth successive quarter.

Viewed by demand item, in domestic demand, private consumption expenditure improved due to an advance in consumer sentiment. In overseas demand, exports of electronic parts and devices increased to China and other Asian countries, reflecting a rapid expansion in worldwide demand for ICT (information and communication technology). [For the revision from the first preliminary estimates, see page 7.]

◆ Production activity in enterprises continues to pick up

Looking at monthly statistics, in the corporate sector, the industrial production index increased in April by 4.0 per cent from the previous month, a rise for the first time in 2

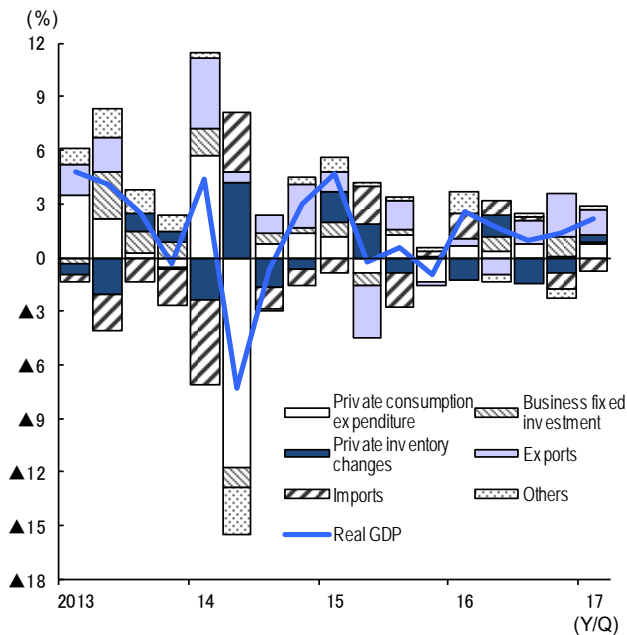
months. By industry, production in a wide range of industries rose, especially in automobiles, of which domestic sales were firm, in industrial or general machinery, and in tool machinery.

The production forecast index also exhibits a rise in June after a fall in May when the period of the stoppage in factory operations in the transport equipment industry is estimated to have been longer than usual in order for workers to make most use of a holiday-packed week early May ("Golden week" in Japanese).

◆ The household sector is expected to recover mildly

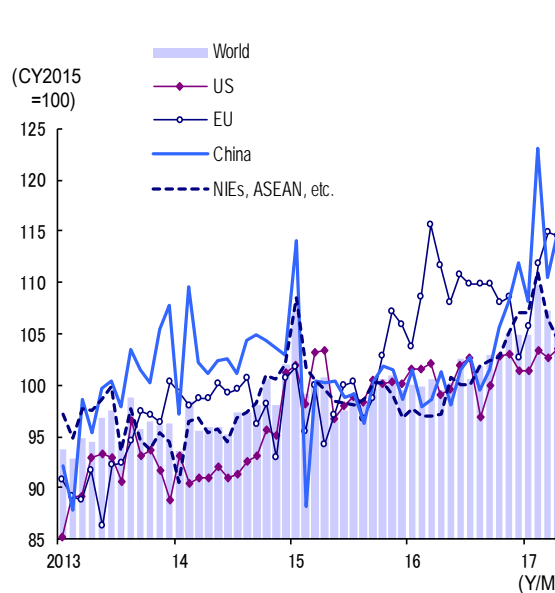
The household sector shows sign of mild pick up. Employment environments continue to improve steadily, as shown in the fact that the active job openings-to-applicants ratio rose in April to 1.48 times, the highest since February 1974. It seems that signs of recovery have spread, as seen in the readings that retail sales value increased by 3.2 per cent year-on-year, a relatively fast pace of rise.

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



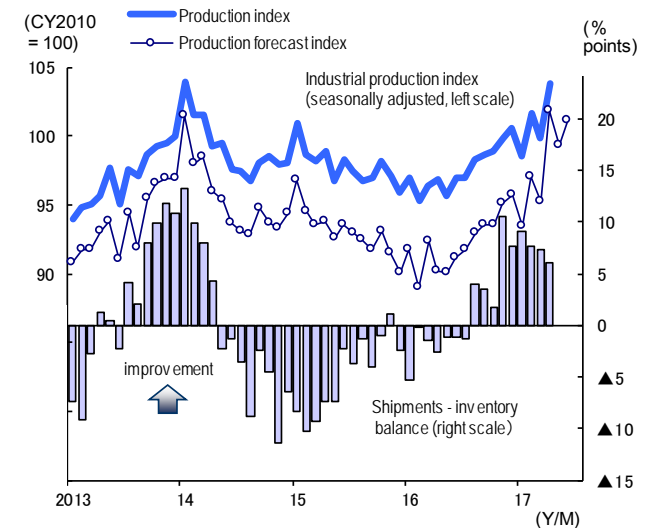
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.

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



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

Figure 2-3 Industrial Production Index and Shipments - Inventory Balance



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

Note: Shipments - inventory balance = y/y % change in shipments - y/y % change in inventory

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Exports are likely to pick up moderately

◆ Inbound demand from foreign tourists to Japan has picked up

Looking at overseas demand, it is notable that inbound demand has picked up. The number of foreign tourists to Japan was 2.58 million during April, up 23.9 per cent on a year earlier. Also, the value spent in Japan per tourist has narrowed its year-on-year decline, owing to the weak yen after November last year.

Looking ahead, taking into account factors such as 1) income among people in Asian emerging countries goes on increasing, and 2) necessary environments for the rising number of foreign tourists including accommodations are likely to improve further in Japan, inbound demand per se will likely stay firm.

◆ Japan's exports of goods will likely continue to pick up, albeit at a moderate pace

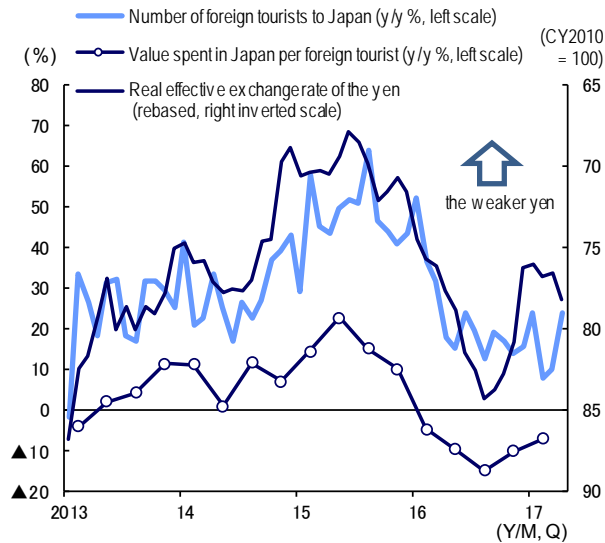
Then, looking at overseas demand more widely by goods, it is remarkable that exports of electronic parts and devices have increased considerably since the second half of last year. This reflects the fact that global ICT demand has expanded

more rapidly than previously expected. The trend is against the background of the surge in demand, for instance, for smartphones with higher performance including high speed communication especially in emerging countries.

Looking ahead, Japan's exports of goods will likely continue to pick up for the time being, as overseas economies keep recovering and worldwide trade volume stays firm. Especially, based on WSTS (World semiconductor trade statistics), it is forecast that the worldwide semiconductor market will go on expanding through 2018.

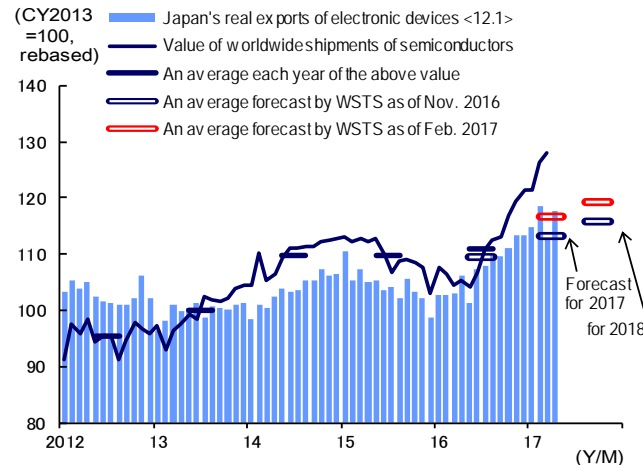
Nonetheless, it is predicted that the pace of the pickup in exports will remain moderate. This tendency is due to the fact that more Japanese enterprises have come to meet the increased overseas demand for their products by expanding production in their overseas facilities, as the shift of production facilities to overseas sites has advanced. In addition, as one of uncertainties, it is worrisome and could affect exports negatively that the Trump administration in the US continues to have a protectionist stance in its trade policy.

Figure 3-1 Value Spent in Japan per Foreign Tourist <year-on-year % change>



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

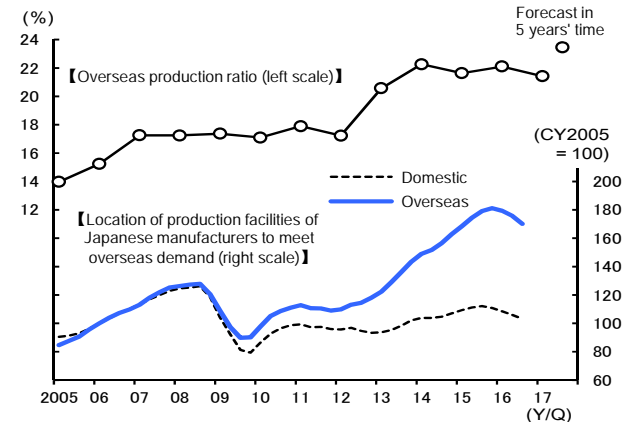
Figure 3-2 Value of Worldwide Shipments of Semiconductors and Japan's Real Exports of Electronic Devices



Source: The Japan Research Institute, Ltd. based on the data of World Semiconductor Trade Statistics (WSTS), Semiconductor Industry Association (SIA), The Ministry of Finance of Japan, The Bank of Japan.

Note: The figure in the angle bracket shows the share in the total nominal exports in FY2016.

Figure 3-3 Location of Production Facilities of Japanese Manufacturers to Meet Overseas Demand



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

Note: The rebased index of domestic production is for nominal exports of goods, and that of overseas production is for sales value (Japan excluded) of overseas facilities. Both are 4-quarter moving averages.

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Corporate profits and business fixed investment will likely remain firm

◆ Corporate profits have shown firmness

As for the corporate sector, current profits have kept their firm trend. Based on the Financial Statements Statistics of Corporations by Industry, the January-March period 2017 saw an increase in both sales value and current profits in 4 quarters in a row, on a seasonally adjusted quarter-on-quarter basis (excluding financial institutions). Sales value increased by 2.2 per cent, contributed to by a recovery in the price of international commodities and a rise in Japan's exports.

Further, current profits, up 2.7 per cent, hit a new high in value on an s.a. quarterly basis, due to the increase in sales value, enterprises' efforts to curb the rate of rise in personnel expenses, a climb in marginal profits stemming from the weaker yen after last November, and so on. Despite uncertainties surrounding, for instance, overseas economies, good profitability in Japanese enterprises has been maintained. Thus, it is highly likely that corporate profits will continue to be firm for the time being.

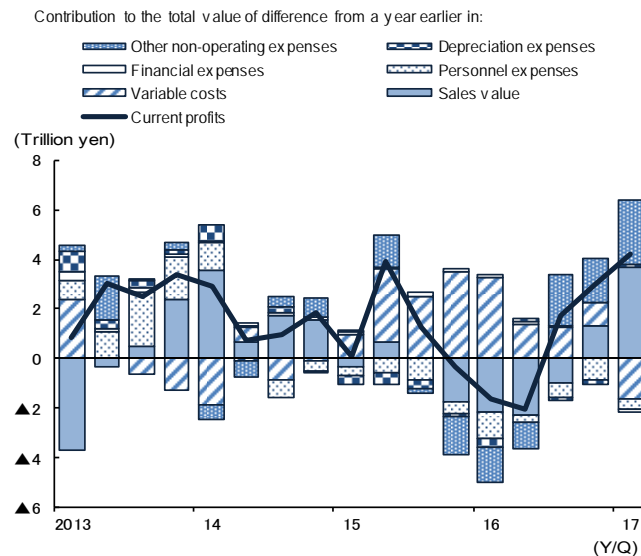
◆ Employment, income, and business investment will likely pick up mildly

Although the pace of rise in average wages is still slow, the situation continues where a sense of a shortage of workers is felt strongly, especially in nonmanufacturers. Also, labour's relative share in total value added is at a historically low level. Thus, employment and income environments will likely continue to improve.

As for business fixed investment, it is very likely that its pick up will continue owing to good corporate profits. Viewed by type, some types of business fixed investment will likely go on supporting the recovery trend on the whole. They are 1) investment for rationalisation and savings reflecting the shortage of workers situation, and 2) construction investment in facilities for nonmanufacturers like accommodations.

However, business fixed investment for capacity expansion is predicted to stagnate, under the circumstance that the ratio of value of business fixed investment to cash flow stays low with economic growth expectations of enterprises remaining sluggish.

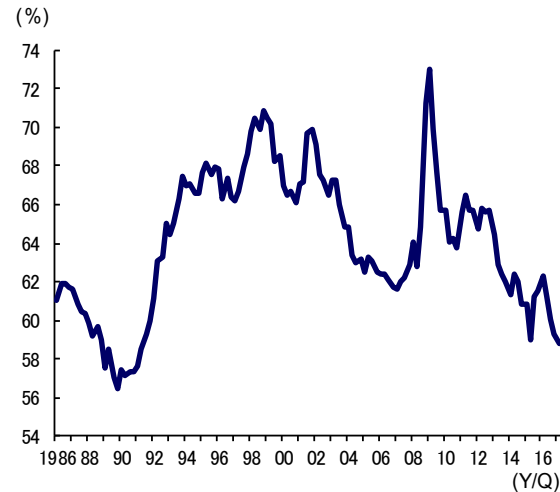
Figure 4-1 Contributions of Factors to the Total Value of Difference from A Year Earlier in Current Profits



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

Note: All industries except for financial institutions.

Figure 4-2 Labour's Relative Share in Total Value Added <seasonally adjusted>

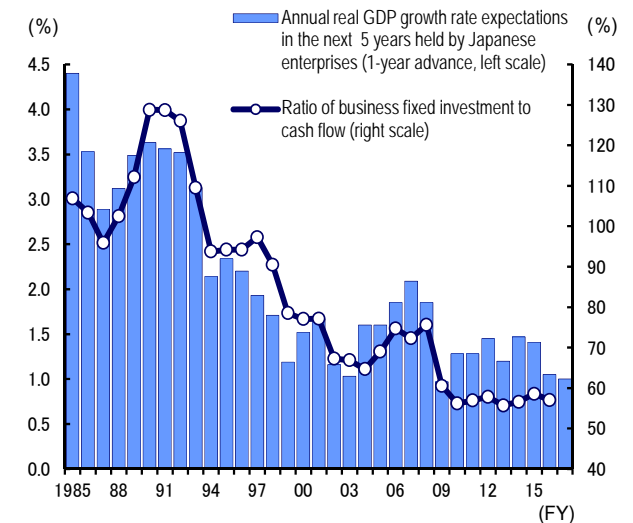


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: 1. All industries excluding financial institutions.

2. Labour's relative share =
personnel expenses / total value added

Figure 4-3 Economic Growth Expectations and Ratio of Business Fixed Investment to Cash Flow



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

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The pace of recovery in income is likely to continue to be very slow

◆ Average wages have been very slow to rise

Employment and income environments are on a mild improvement trend. Also, as a modest pace of pick up in economic activity continues, it is hoped that the situation of labour shortages will step up pressure on wage rises. As matters stand, average wages have been considerably slow to increase.

Analysis of the reasons by size of enterprise shows that, first, it is mainly small enterprises with less than 100 employees that have raised the wages for their employees. Yet, in this size of enterprises, the number of employees has fallen.

Second, in larger enterprises, 1) the average rate of wage rises in wage negotiations this spring is estimated to have remained almost the same as that last year, with large enterprises being very conscious of future uncertainties surrounding, for example, overseas economies. 2) They have seen an increase in the number of employees. However, it is the types of employees with lower wages such as new graduates and elderly persons in extended employment periods that have mainly increased, rather than full-time employees with higher wages.

All of these seem to have contributed to the very slow pace of wage rises.

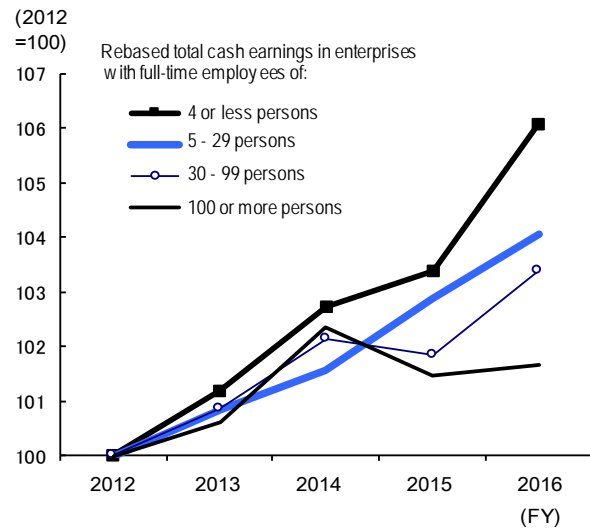
◆ Slow pace of recovery in real income will likely continue

Looking ahead, the improvement in employment environments will likely continue, reflecting the mild recovery trend in economic activity.

Yet, as for wage rises, it is predicted that the pace of rise in regular-time pay will stay slow, against the background of the low rate of wage increases in the wage negotiation results this spring. With respect to bonuses, this summer bonuses are estimated to have been stagnant, still negatively affected by the downswing in corporate profits due to the strong yen through late autumn last year. Nonetheless, the boosting effect on corporate profits stemming from the depreciation of the yen after last November is likely to push up year-end bonuses and thereafter.

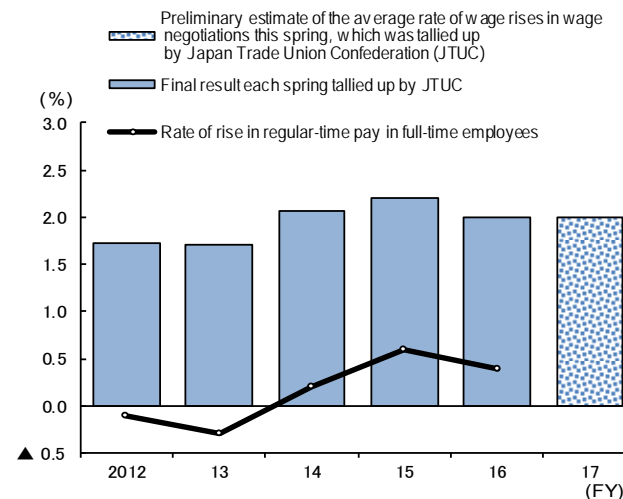
Regarding the price factor, the year-on-year change rate in consumer prices has turned positive, due to energy price rises and the effect of the weaker yen. As an unfavourable element, this will likely add downward pressure on real purchasing power of households.

Figure 5-1 Total Cash Earnings in Full-Time Workers by Size of Enterprises <re-based>



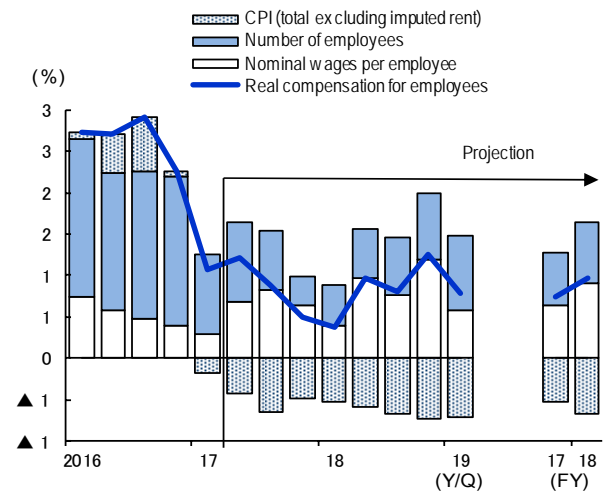
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labour and Welfare.

Figure 5-2 Results in Spring Wage Negotiations and Regular-Time Pay <year-on-year % change>



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

Figure 5-3 Contributions to the Year-on-Year Change Rate in Real Compensation for Employees



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

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Private consumption expenditure is on a mild recovery trend

◆ Private consumption expenditure shows signs of recovery

Private consumption expenditure is on a mild recovery trend. Viewed by item, a reactionary fall in expenditure on durable goods seems to have come to an end. This reactionary fall had been caused by 1) promoting measures for consumption after 2009, and 2) a last minute surge in demand before the rise in the consumption tax rate in 2014. Regarding automobiles, sales have picked up since April this year, as negative effects of sales suspension, resulting from the falsifying of fuel economy data by a light vehicle manufacturer, have petered out.

As for expenditure on services, a recovery has been seen, for example, in eating out. These trends of recovery reflect a continued improvement in employment and income environments and an advance in consumer sentiment. Other factors such as the slowing down in the surge in food prices after early this year have also contributed to supporting the recovery in consumption as a whole.

◆ Slow pace of recovery in private consumption will likely continue

Looking ahead, the continued improvement in employment environments will likely go on bolstering the recovery in private consumption expenditure. However, the pace

of the pickup is highly likely to remain slow. One of the main reasons is that both a considerably slow pace of wage rises and an increase in payments of social insurance premiums continue to weigh on disposable income.

Further, by age cohort, it is notable that the propensity to consume in the cohort less than the mid-30's has declined remarkably. The grounds for this are estimated to be 1) that no new attractive products or services have been produced which can boost the consumption of younger generation powerfully, 2) that this cohort of consumers tends to be economical or saving-oriented against the background of anxiety about their future, and 3) households which bought a house have increased under continued low interest rate environments, and, as a result, the burden of mortgage (housing loan) repayments has come to have suppressed their private consumption expenditure.

With respect to the cohort where the head of household is 60 years old or more, they feel keen anxiety over inflation. Accordingly, the fact that the year-on-year change rate in consumer prices has turned positive of late will likely weigh on their consumption expenditure.

Figure 6-1 Change in Consumer Sentiment by Consumer Confidence Perception

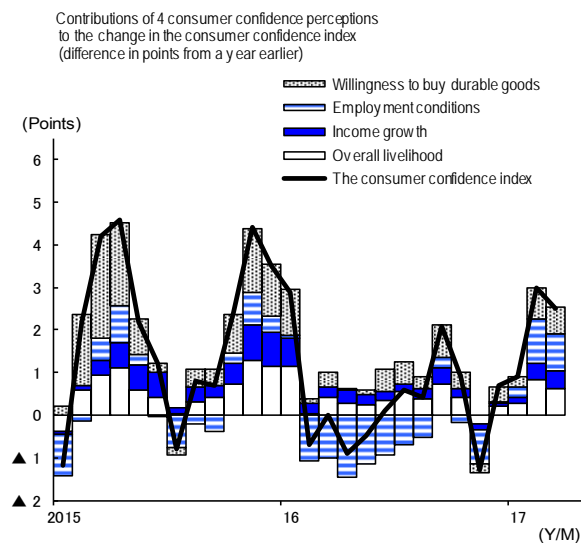


Figure 6-2 Average Propensity to Consume by the Age of the Household Head <4-quarter moving average>

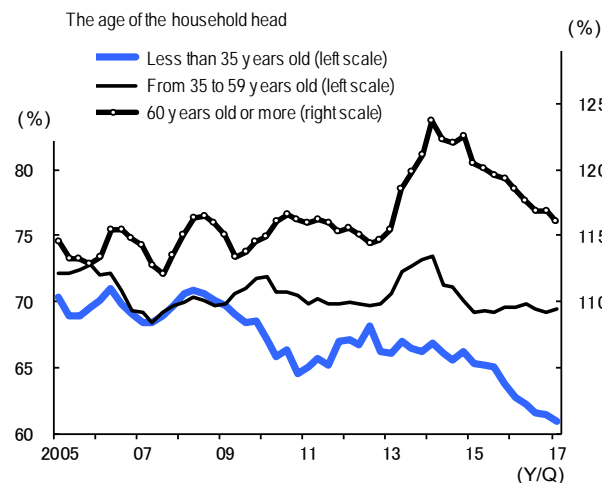
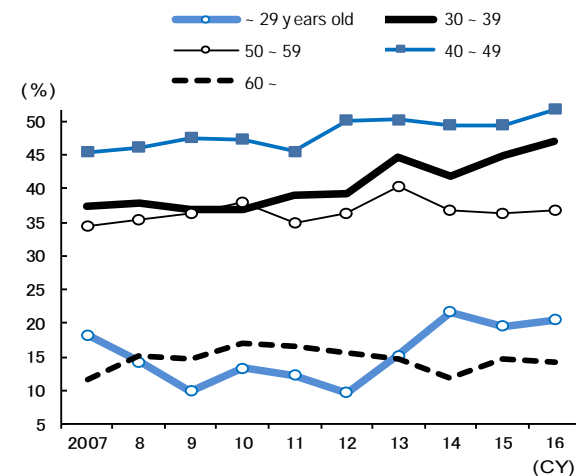


Figure 6-3 Ratio of Households with Mortgage Repayments in Each Cohort by Age of Head of Households



Prospects for Japan's economy - Projected real GDP change; 1.4% in FY2017 and 1.1% in FY2018

◆ Japan's economic activity will likely continue its recovery trend, against the background of an expansion in overseas economies and firm domestic demand

(1) Japan's real GDP in the January-March period this year grew by 1.0 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates), a positive growth for the fifth successive quarter.

This figure of 1.0 per cent was revised downwards from 2.2 per cent in the first preliminary estimate. The main reason for the downward revision was a downswing in private inventory changes. Viewed by type of inventories, it was notable that the inventories of basic materials decreased considerably. This significant decline is surmised to have been caused by the decrease in inventories of crude oil and natural gas. It also seems to have been brought about by the situation where the purchase of basic materials in order to restock inventories was simply unable to catch up with the rapid pace of use of these materials in production, having led to the temporary pushing down in the real GDP growth rate in Q1.

Meanwhile, except for the downward effect of inventory changes, the final demand in the second preliminary estimates was as firm as that in the first preliminary estimates, as shown in the fact that business fixed investment was revised upwards. Accordingly, there is no alteration in the JRI view that Japan's economic activity continues to be on a recovery trend.

(2) Looking ahead, it is predicted that the economy will continue its recovery trend.

Although uncertainties surrounding the overseas political and economic situation remain, the following are likely to play a bolstering role for the economy. These are 1) an increase in industrial production in order to build up a necessary level of inventory again, 2) a rise in exports reflecting an expansion in worldwide demand for ICT (information and communication technology) and the recovery in business fixed investment overseas, 3) buoyant domestic construction investment in nonmanufacturing such as redevelopment projects in the metropolitan areas, and 4) continued improvement in employment and income environments against the background of labour shortages.

In addition, a pickup in public investment stemming from the implementation of the economic measures of the government will likely boost economic activity especially in the first half of this fiscal year. Accordingly, it is projected that real GDP

in FY2017 will grow by 1.4 per cent.

(3) With respect to economic activity in FY2018, it is predicted that the trend of recovery will be sustained. This is because domestic demand will likely be firm against the background of an increase in demand for construction relating to the 2020 Tokyo Olympic and Paralympic Games. Also, Japan's exports will likely be supported by an acceleration in the pace of overseas economic growth, mainly led by the solid US economy.

However, unfavourable factors are also likely to be seen, such as 1) the boosting effect from the implementation of the economic measures of the government will fizzle out, and 2) a strong expansion in private consumption expenditure is unlikely to be counted on, taking into consideration weighing factors such as a rise in social insurance premiums and an increase in the number of pensioner households. Therefore, it is projected that the rate of annual growth in real GDP will decelerate to 1.1 per cent in FY2018.

◆ The year-on-year change rate in the core CPI will likely be on a gradual rising trend

(4) The core CPI, which excludes fresh food, has enlarged the extent of its year-on-year increase, albeit slightly, since having turned into positive territory in January. Although the price of durable goods continues to fall, a recovery or an acceleration in the prices of energy and food has contributed to pushing up the total rate of increase on a year earlier.

Looking ahead, it is predicted that the pace of a year-on-year increase in the core CPI will accelerate gradually due to factors such as a pickup in the price of natural resources and the effect of the depreciation of the yen. Nonetheless, the rate of increase in the core CPI will likely be below the year-on-year 2 per cent target set by the BoJ, taking into account the prediction that domestic economic activity and the tempo of wage rises will likely continue to lack strong enough momentum.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of June 8, 2017)

	(seasonally adjusted, annualised % changes from the previous quarter)										(% changes from the previous fiscal year)			
	CY2016		CY2017				CY2018				CY2019	FY2016	FY2017	FY2018
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)	
	(Actual)	(Actual)	(Projection)				(Projection)				(Projection)	(Actual)	(Projection)	(Projection)
Real GDP	1.4	1.0	2.2	1.3	1.0	0.9	1.1	1.3	1.3	1.2	1.2	1.4	1.1	
Private Consumption Expenditure	0.1	1.1	0.6	0.7	0.8	0.8	0.7	0.7	0.8	0.8	0.6	0.8	0.8	
Housing Investment	0.8	1.1	▲ 1.8	▲ 3.5	▲ 2.4	0.3	0.5	0.6	0.8	1.0	6.3	▲ 0.5	▲ 0.1	
Business Fixed Investment	7.9	2.5	2.6	2.7	2.9	2.9	3.0	3.0	2.9	2.9	2.5	3.1	2.9	
Private Inventories (percentage points contribution)	(▲ 0.8)	(▲ 0.6)	(0.8)	(0.2)	(▲ 0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.4)	(▲ 0.1)	(0.0)	
Government Consumption Expenditure	0.2	▲ 0.0	0.8	0.9	1.1	1.1	1.2	1.2	1.2	1.2	0.4	0.6	1.1	
Public Investment	▲ 11.5	▲ 0.6	17.6	9.7	▲ 1.4	▲ 4.9	▲ 2.0	1.6	0.7	▲ 1.2	▲ 3.2	3.7	▲ 0.8	
Net Exports (percentage points contribution)	(1.5)	(0.6)	(▲ 0.2)	(▲ 0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.8)	(0.3)	(0.1)	
Exports of Goods and Services	14.1	8.7	2.6	2.0	2.5	2.6	2.7	2.8	2.8	2.8	3.1	5.3	2.6	
Imports of Goods and Services	5.3	5.6	3.7	3.0	2.0	2.1	2.1	2.2	2.2	2.1	▲ 1.4	3.5	2.2	
(Ref.) Domestic Private Demand (percentage points contribution)	(0.5)	(0.5)	(1.5)	(0.9)	(0.8)	(0.9)	(0.9)	(0.9)	(0.9)	(0.9)	(0.5)	(0.8)	(0.9)	
(Ref.) Public Demand (percentage points contribution)	(▲ 0.6)	(▲ 0.0)	(0.9)	(0.6)	(0.1)	(▲ 0.0)	(0.1)	(0.3)	(0.3)	(0.2)	(▲ 0.1)	(0.3)	(0.2)	

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	1.6	0.5	0.9	1.4	1.4	2.0	1.4	1.5	1.6	1.9	1.1	1.4	1.6
GDP deflator	▲ 0.0	▲ 0.8	▲ 0.5	▲ 0.1	▲ 0.0	0.7	0.4	0.4	0.5	0.7	▲ 0.2	0.0	0.5
Consumer Price Index (excluding fresh food)	▲ 0.3	0.2	0.4	0.7	0.9	0.9	1.0	1.0	1.0	1.1	▲ 0.2	0.7	1.0
Unemployment Rate (%)	3.0	2.9	2.8	2.8	2.8	2.7	2.7	2.7	2.6	2.6	3.0	2.8	2.7
Exchange Rates (JY/US\$)	109	114	111	113	114	115	116	116	116	116	108	113	116
Import Price of Crude Oil (US\$/barrel)	46	55	54	58	60	60	61	62	63	64	47	58	63

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.