

Monthly Report of Prospects for Japan's Economy

August 2017

Macro Economic Research Centre
Economics Department



The Japan Research Institute, Limited

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

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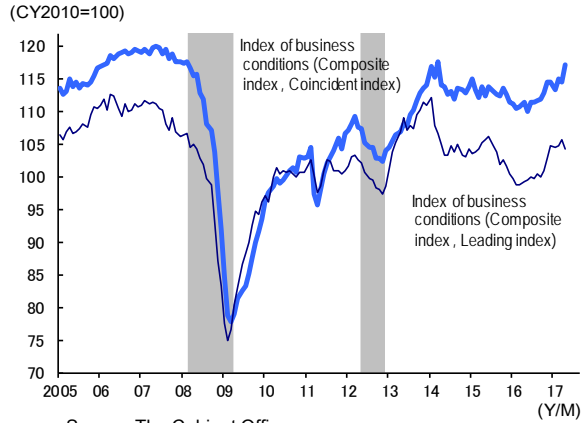
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The general situation of Japan's economy – Economic activity continues its mild recovery trend

Figure 1-1 Economic Activity

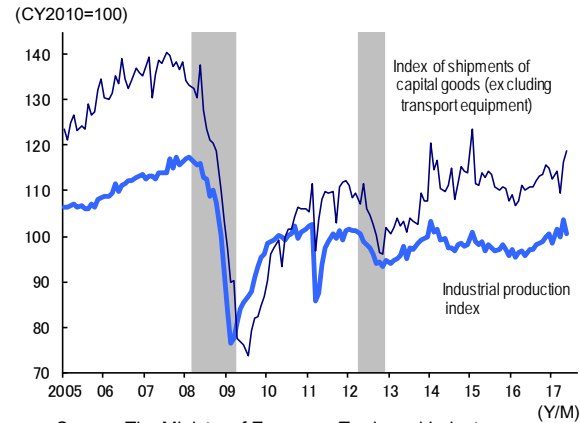
The coincident index rose from the previous month noticeably, to the highest level since March 2014.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

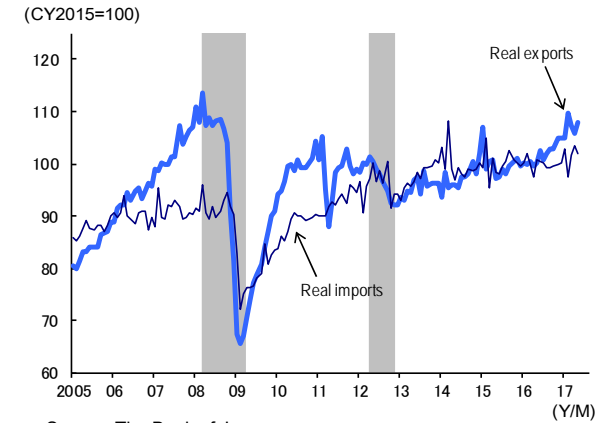
The production index has maintained its increasing trend on the whole since the first half of last year, albeit while moving up and down.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

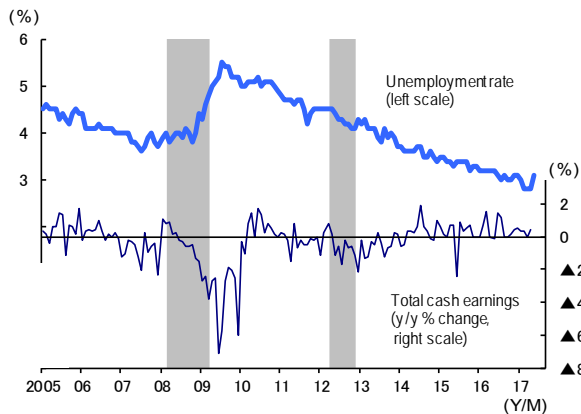
Exports to Europe, especially, expanded strongly. Imports declined for the first time in 3 months.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate rose month-on-month for the first time in 6 months. As for total cash earnings, regular-time pay turned positive year-on-year.

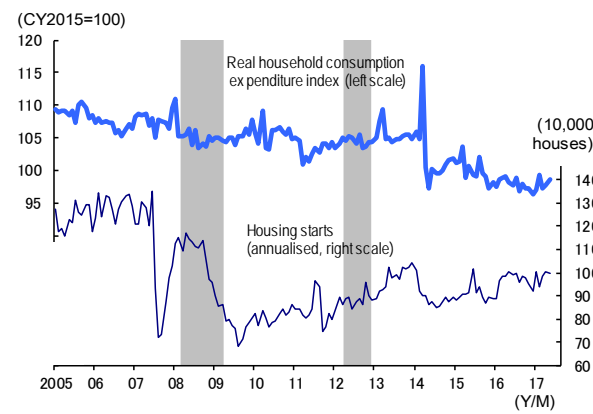


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

* The shaded area indicates the phase of recession.

Figure 1-5 The Household Sector

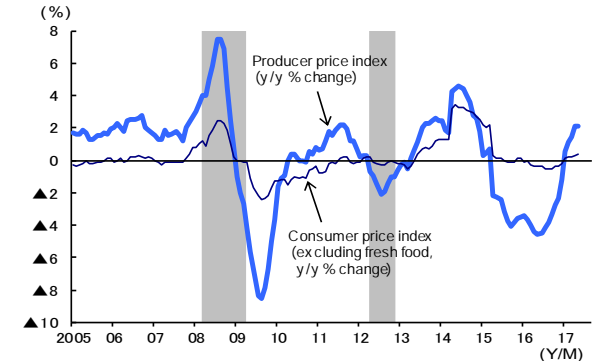
Household consumption expenditure has showed signs of recovery, reflecting the improvement in consumer sentiment. As for housing starts, condos for sale decreased significantly.



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

Figure 1-6 Prices

The rapid pace of year-on-year increase in producer prices took a breather. Core consumer prices increased on a year earlier for 5 months running, albeit to a slight extent.



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

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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.

In the corporate sector, the industrial production index decreased in May by 3.6 per cent from the previous month. One of the reasons for this was a reactionary fall from the considerable rise in April in industries such as transport equipment. Another was a longer-than-usual period of the stoppage in factory operations during early May including a holiday-packed week ("Golden week" in Japanese).

However, the production forecast index exhibits a rise in June, led by transport equipment and electrical machinery industries, followed by the production in July which is forecast to be almost flat. Thus, it can be judged that industrial production has kept its increasing trend on the whole since the first half of last year, albeit while moving up and down.

As for exports, although exports to Asia seem to have slowed down, those to

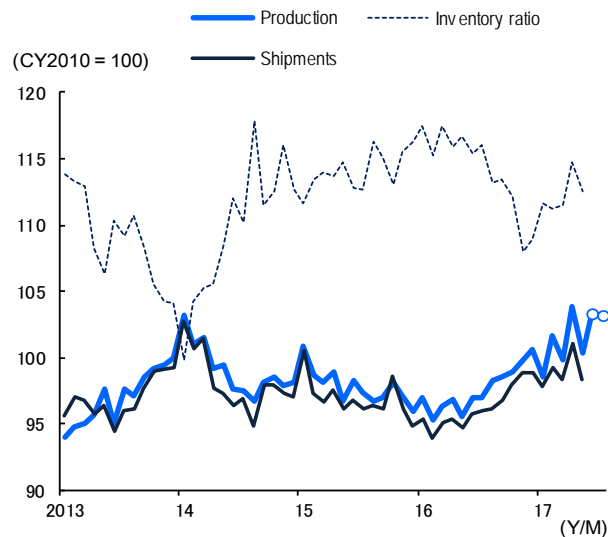
Europe and the US have increased, having pushed up total exports.

◆ The household sector is expected to recover mildly

The household sector shows signs of mild pickup. Employment environments continue to improve steadily, as shown in the fact that the active job openings-to-applicants ratio rose in May to 1.49 times, the highest since February 1974. As the labour force participation rates in women and elderly persons have risen, the number of employees continues to increase.

Meanwhile, the pace of recovery in private consumption expenditure seems to have accelerated slightly since early this year, due to 1) the improvement in consumer sentiment partly reflecting the stock price rise, and 2) the increase in the expenditure on the purchase of automobiles, affected positively by renewals. Yet, a sort of fragility still remains, which is seen in, for instance, sluggish sales of summer clothing caused by unusually low temperatures in the first of May.

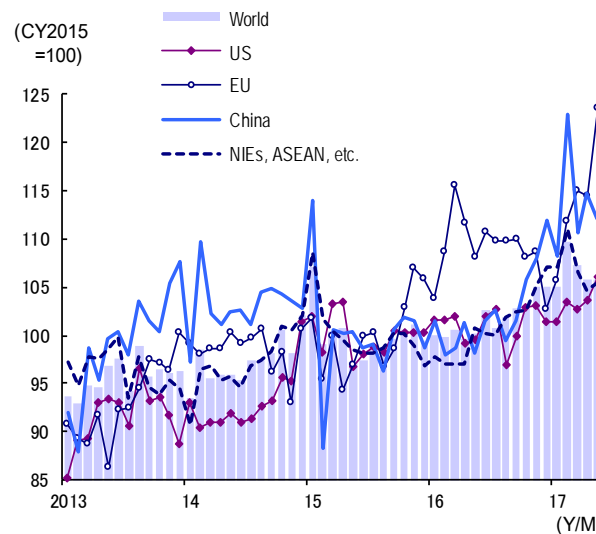
Figure 2-1 Indices of Industrial Production <seasonally adjusted>



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

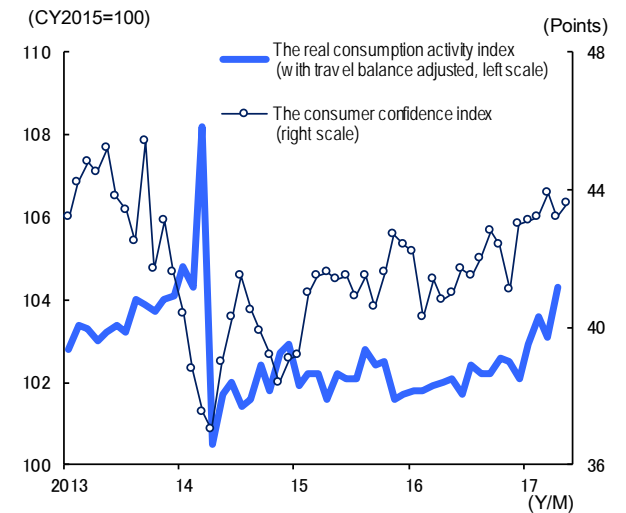
Note: The latest two figures in production are based on the production forecast index.

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 Real Consumption Activity and Consumer Sentiment



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

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BoJ's Tankan Survey - Business sentiment improved due to the increase in exports and profits

◆ Business sentiment improved due to the increase in exports, the stock price rise, and good corporate profits

In the Tankan June 2017 Survey, the diffusion index (DI) for business conditions on the whole of large manufacturing rose by 5 to +17 percentage points, an advance in 3 quarters running. The DI for the whole of large nonmanufacturing also rose by 3 to +23 percentage points, an improvement for the second successive quarter.

Viewed by industry, in manufacturers, the DIs for industries increased both in basic materials and in processed or manufactured goods, due to the picking up in exports, the rise in stock prices, continued good corporate profits, etc.

In nonmanufacturers, the DIs in construction-related industries were firm, thanks to increased re-development projects in metropolitan areas and a rise in public works stemming from economic measures. Also, the private consumption-related DIs recovered, partly bolstered by a pickup in inbound demand.

As for the forecast DIs in 3 months' time, the survey results seem to suggest that solid corporate profits will likely support business sentiment. Yet, cautious views over

the future are growing among enterprises, having resulted in the decline in the forecast DIs. This unfavourable outlook is brought about domestically by, for instance, anxiety mainly among small and medium-sized enterprises over continued labour shortages. Globally, it is caused by uncertainties surrounding the political situation overseas, such as the policy stance taken by the Trump administration.

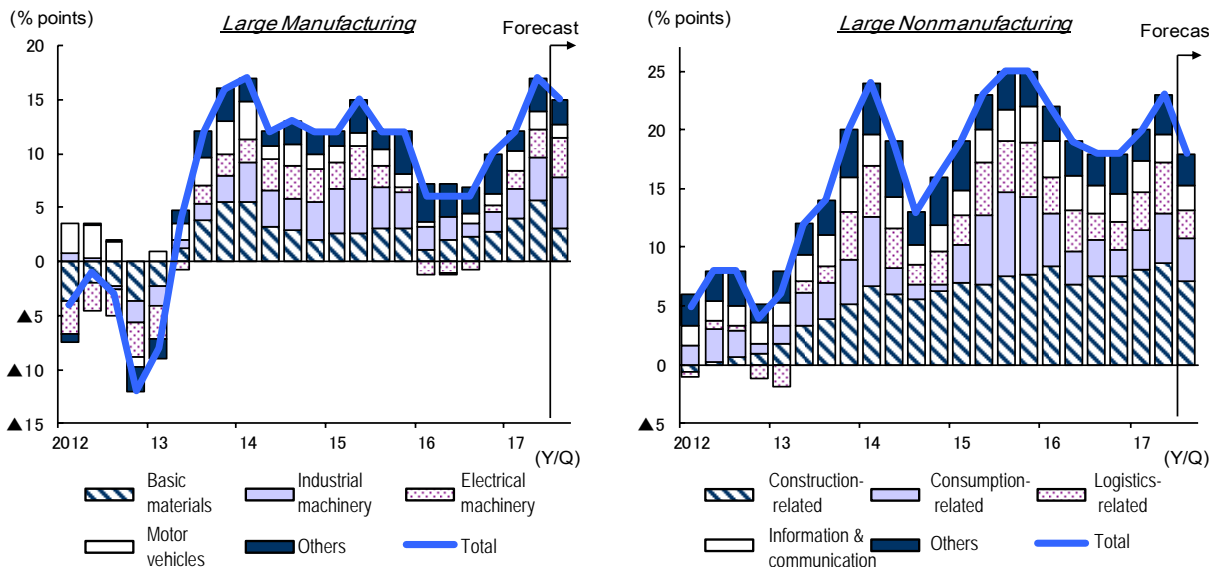
◆ Planned business fixed investment for FY2017 was firm

In the same Survey, the actual result of annual change rate in business fixed investment for FY2016 was +0.4 per cent in all types and sizes of enterprises. It is noteworthy that the attitude to investment in larger nonmanufacturers became more and more cautious in the second half of FY2016.

However, looking at the planned annual change rates for FY2017, the figures in June were revised upwards from the previous results both in manufacturers and nonmanufacturers, as if they followed the trajectories in several recent fiscal years. Taking the result into consideration, it is predicted that business fixed investment during FY2017 will pick up amid continued good corporate profits.

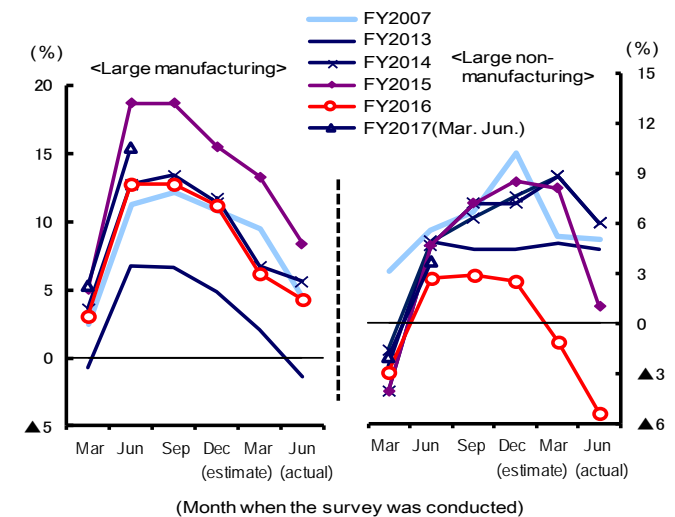
Figure 3-1 Contributions to Business Conditions Diffusion Index by Industry

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



Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, "The Tankan June 2017 Survey".

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



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

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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 2.30 million during May, up 21.2 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 moderately

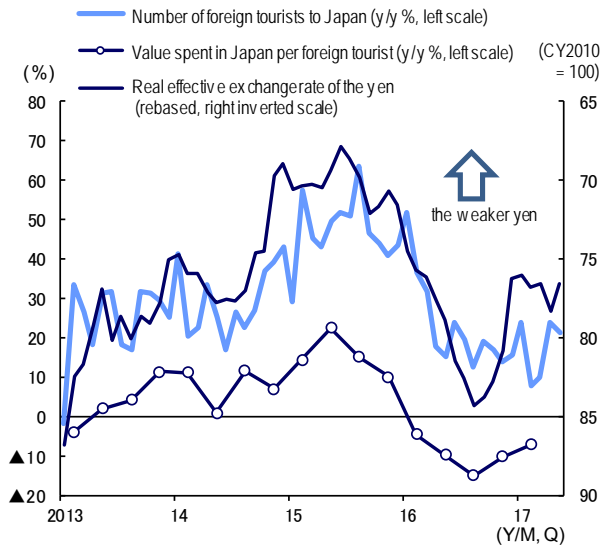
Then, looking at overseas demand more widely by goods, it should be noted that the pace of rise in exports of electronic parts and devices, which had increased considerably since the second half of last year, has slowed of late. Judging from the forecasts made by World Semiconductor Trade Statistics (WSTS), it is possible that

worldwide demand for semiconductors could have entered the adjustment phase.

However, in the medium and long term, it is predicted that worldwide demand for semiconductors will continue its expanding trend, driven by a further spread of such uses as cloud computing services, IoT(Internet of Things), and an incorporation into automobiles. Accordingly, Japan's exports of electronic parts and devices will likely stay firm, albeit with some temporary downswings. Also, it is expected that exports of capital goods will continue to be solid for the time being, as a worldwide recovery in business fixed investment is predicted.

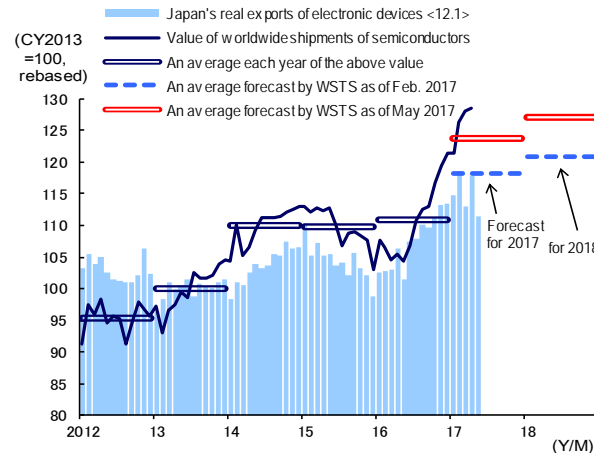
Yet, the pace of the pickup in exports will likely remain moderate. This tendency is due to the fact that more Japanese enterprises have come to meet the increased overseas demand for their products by expanding production in their overseas facilities, as the shift of production facilities to overseas sites has advanced. Also, it is worrisome and could affect exports negatively that there are a lot of uncertainties surrounding the policy management exercised by the Trump administration.

Figure 4-1 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.

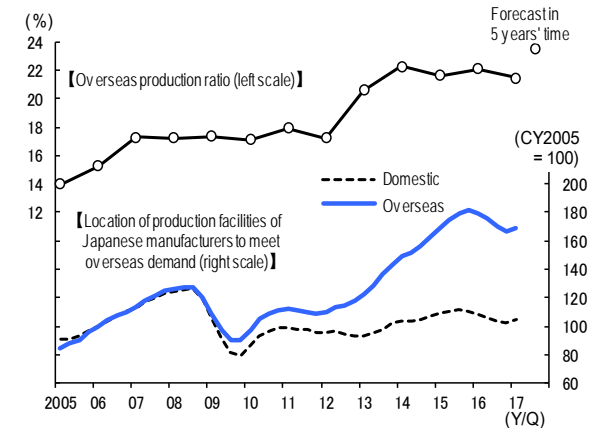
Figure 4-2 Value of Worldwide Shipments of Semiconductors and Japan's Real Exports of Electronic Devices



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 4-3 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

Corporate profits in Japanese enterprises are going well. As for sales value, a rise has been visibly seen in industries such as basic materials and wholesaling, which benefited from an improvement in international commodity prices, and processed or manufactured goods, to which a rise in their exports contributed positively.

Current profits have kept their highest level ever. Boosting factors appear to be that 1) relative to the firm increase in sales value, the rate of rise in personnel expenses has been curbed, 2) marginal profits from the exchange rates have climbed thanks to the weaker yen after last November, and so on.

It has also contributed that the power of Japanese enterprises making profits from overseas activity has strengthened. The heightened capability of gaining profits is shown in the fact that, for example, the amount of receipt of royalties arising from intellectual property rights, which is sent by overseas subsidiaries, has increased.

Thus, good profitability in Japanese enterprises has been maintained. Therefore,

corporate profits are highly likely to continue to be firm for the time being.

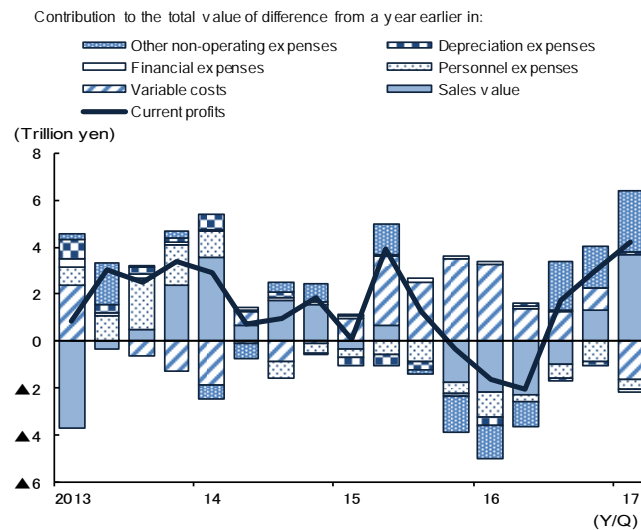
◆ Income and business investment will likely pick up mildly

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. Also, labour's relative share in total value added is at a historically low level. Hence, employment and income environments will likely continue to improve.

As for business fixed investment, it is very likely that its pickup 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 be limited. Namely, the scale of this type of investment, as defined by the ratio to cash flow, is highly likely to stay flat.

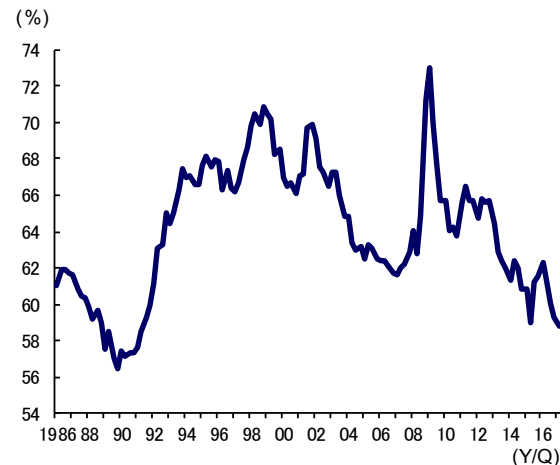
Figure 5-1 Contributions of Factors to the Total Value of Difference from A Year Earlier in Current Profits



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

Note: All industries except for financial institutions.

Figure 5-2 Labour's Relative Share in Total Value Added <seasonally adjusted>

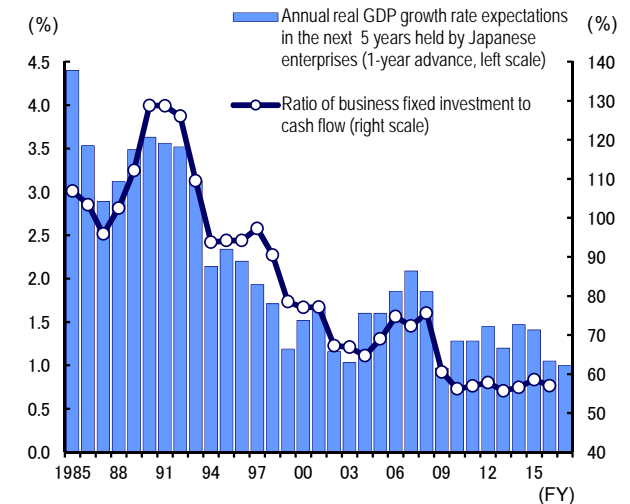


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: 1. All industries excluding financial institutions.

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

Figure 5-3 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 pickup 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. Yet, in this size of enterprises, the number of employees has not increased much.

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.

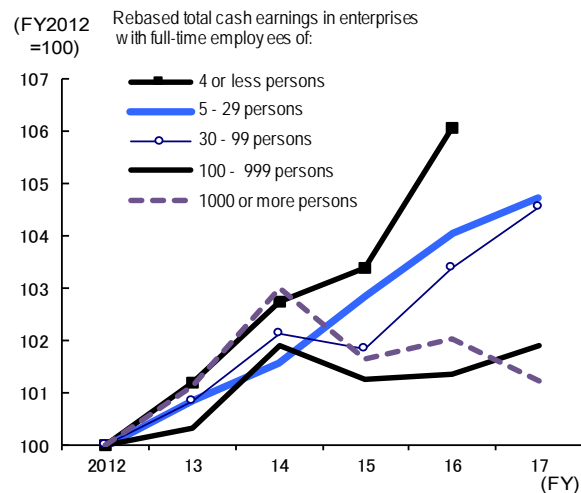
◆ Slow pace of recovery in real income will likely continue

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

However, 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 the real purchasing power of households.

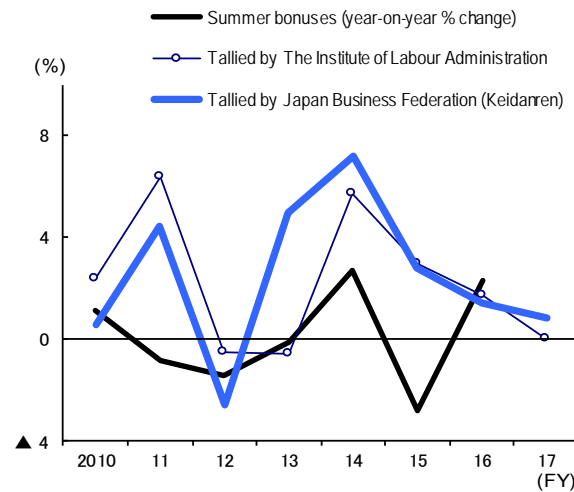
Figure 6-1 Total Cash Earnings in Full-Time Workers by Size of Enterprises <rebased>



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

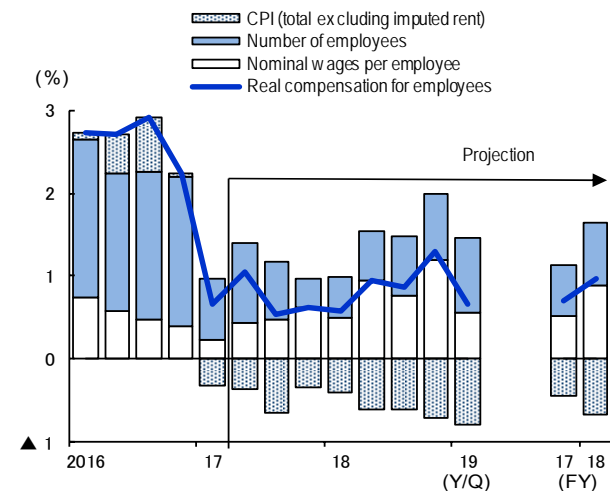
Note: The figures in FY2017 are estimates which are calculated based on the year-on-year change in April 2017.

Figure 6-2 Summer Bonuses <year-on-year % change>



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

Figure 6-3 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 stock price rise and the slowing 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

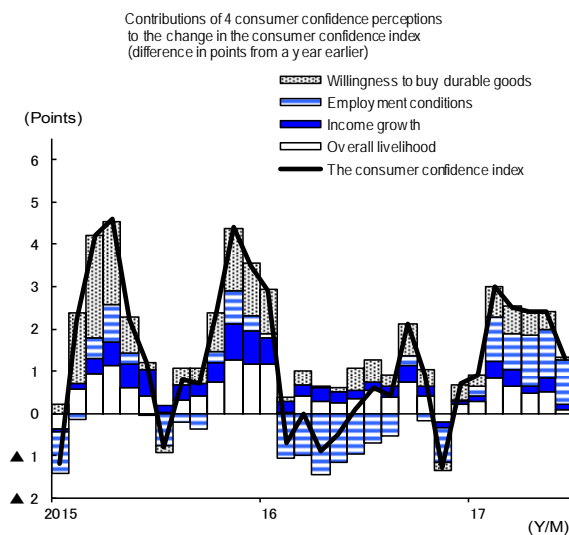
Looking ahead, the continued improvement in employment environments will likely go on bolstering the recovery in private consumption expenditure. However, the pace

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 that 1) no new attractive products or services have been produced which can boost the consumption of younger generation powerfully, 2) this cohort of consumers tends to be economical or saving-oriented against the background of anxiety about their future, and 3) the ratio of households which bought a house has risen under continued low interest rate environments, and, as a result, the increased burden of mortgage (housing loan) repayments has come to have suppressed the total private consumption expenditure.

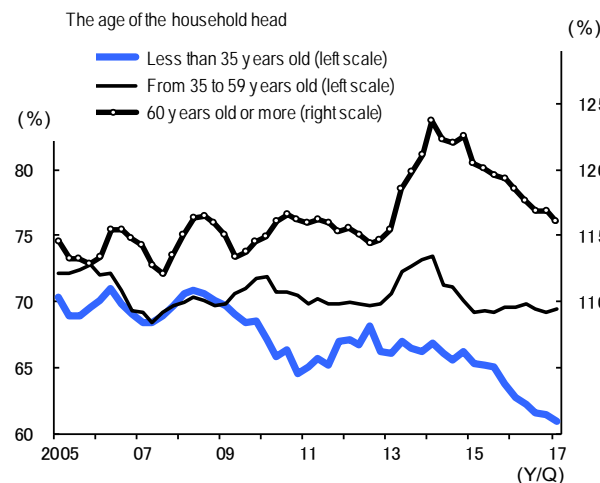
With respect to the cohort where the head of household is 60 years old or more, they feel keen anxiety over inflation. Accordingly, the fact that the year-on-year change rate in consumer prices has turned positive of late will likely weigh on their consumption expenditure.

Figure 7-1 Change in Consumer Sentiment by Consumer Confidence Perception



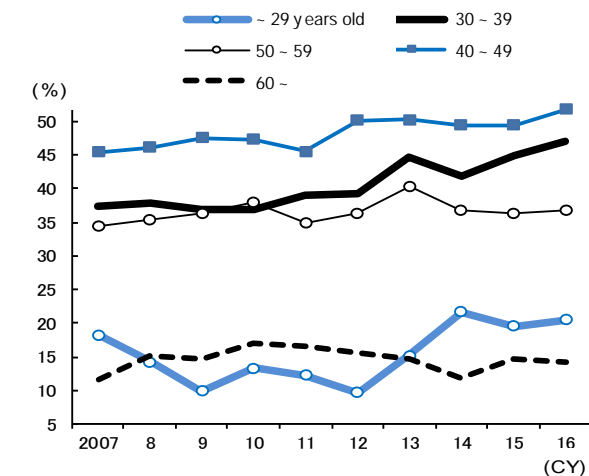
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.

Figure 7-2 Average Propensity to Consume by the Age of the Household Head <4-quarter moving average>



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

Figure 7-3 Ratio of Households with Mortgage Repayments in Each Cohort by Age of Head of Households



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

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

◆ Japan's economic activity will likely continue its recovery trend, against the background of firm demand at home and abroad

(1) 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, and 3) buoyant domestic construction investment in nonmanufacturing such as redevelopment projects in the metropolitan areas, and accommodations for the rising number of foreign tourists to Japan.

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.

(2) With respect to economic activity in FY2018, it is predicted that the trend of recovery will be sustained. This is because 1) Japan's exports will likely continue their rising trend, as an acceleration in the pace of overseas economic growth is predicted, mainly led by the solid US economy. Also, 2) domestic demand will likely be firm against the background of continued improvement in employment and income environments reflecting labour shortages, and an increase in demand for construction related to the 2020 Tokyo Olympic and Paralympic Games.

However, after the boosting effect from the implementation of the economic measures of the government fizzles out, and the surge in demand for ITC turns slower, the pace of real GDP growth is projected to decelerate. Also, as a strong expansion in private consumption expenditure is unlikely to be counted on, the situation could continue where it is hard for economic activity to gain enough momentum. Therefore, it is projected that the rate of annual growth in real GDP will likely slow down 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

(3) 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 rise 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 9 Projections for GDP Growth and Main Indicators of Japan (as of July 3, 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)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Actual)	(Projection)	(Projection)	
Real GDP	1.4	1.0	2.1	1.5	1.1	0.9	0.9	1.2	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)	(1.0)	(0.5)	(0.2)	(0.0)	(▲ 0.2)	(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)	(▲ 0.5)	(▲ 0.3)	(▲ 0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.8)	(0.2)	(0.1)	
Exports of Goods and Services	14.1	8.7	1.5	2.0	2.5	2.6	2.7	2.8	2.8	2.8	3.1	5.0	2.6	
Imports of Goods and Services	5.3	5.6	4.8	3.6	2.9	2.1	2.1	2.2	2.2	2.1	▲ 1.4	4.0	2.3	
(Ref.) Domestic Private Demand (percentage points contribution)	(0.5)	(0.5)	(1.8)	(1.2)	(1.1)	(0.9)	(0.7)	(0.9)	(0.9)	(0.9)	(0.5)	(0.9)	(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	2.1	1.5	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	0.6	0.8	0.8	0.8	1.0	1.0	1.1	▲ 0.2	0.7	1.0
Unemployment Rate (%)	3.0	2.9	2.9	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	115	116	116	116	108	113	116
Import Price of Crude Oil (US\$/barrel)	46	55	54	52	58	60	61	62	63	64	47	56	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.