

Monthly Report of Prospects for Japan's Economy

September 2017

Macro Economic Research Centre
Economics Department



The Japan Research Institute, Limited

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

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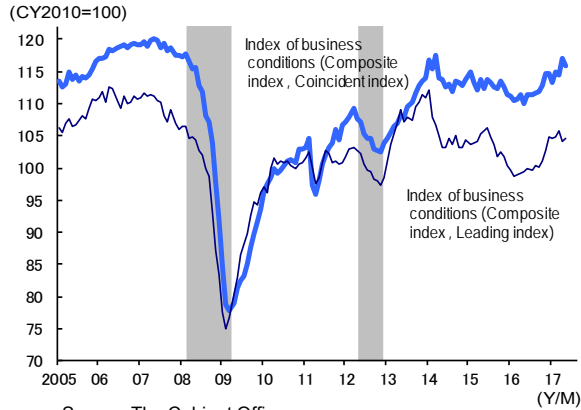
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The general situation of Japan's economy – Economic activity continues its mild recovery trend

Figure 1-1 Economic Activity

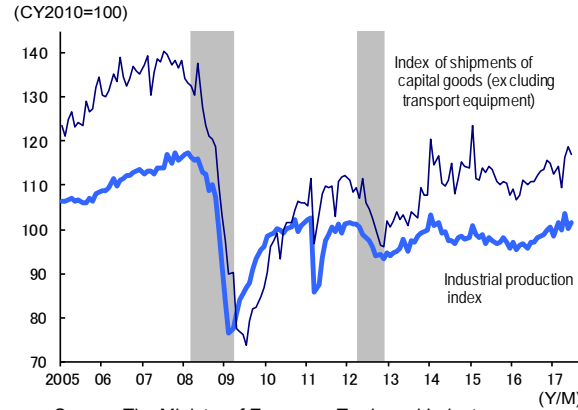
The leading index rose from the previous month for the first time in 2 months, due to an increase in consumption of final goods and an improvement in consumer sentiment.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

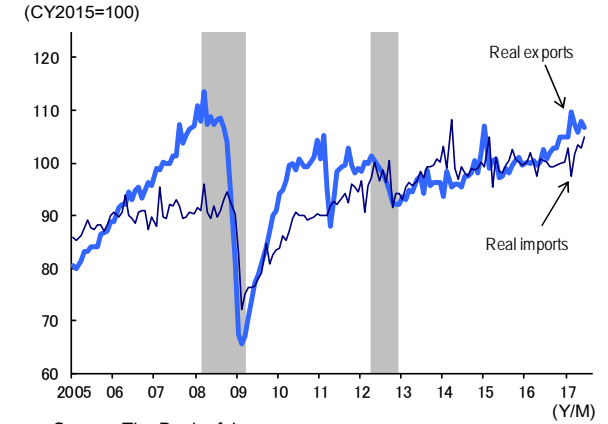
The production index has maintained its increasing trend on the whole, albeit while moving up and down. Shipments of capital goods declined for the first time in 2 months.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

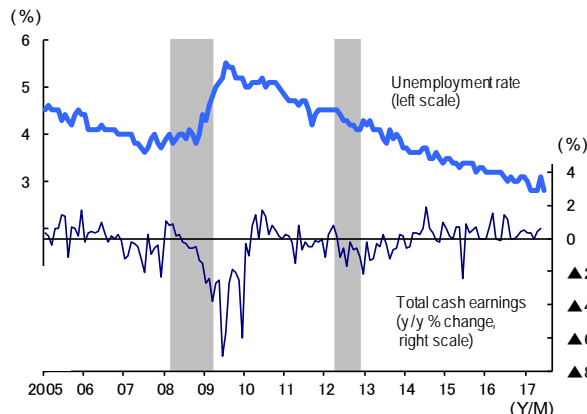
The pace of rise in exports to destinations such as Asia took a breather. Imports climbed for the first time in 2 months.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate fell month-on-month for the first time in 4 months. As for total cash earnings, regular-time pay stayed positive year-on-year.

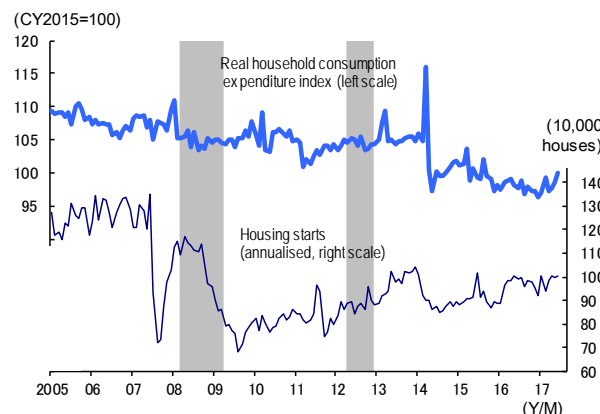


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

* The shaded area indicates the phase of recession.

Figure 1-5 The Household Sector

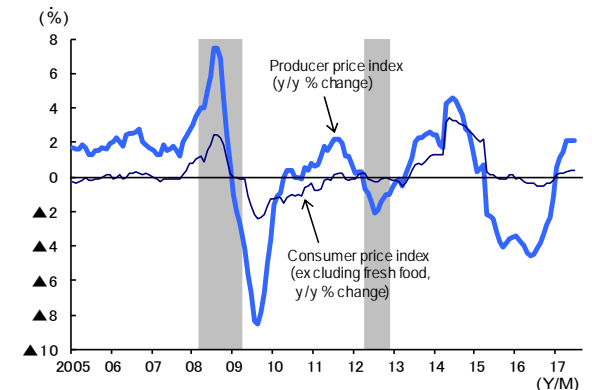
Household consumption expenditure, which had weakened, has shown signs of recovery. Housing starts have been firm, led by houses for sale.



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 paused. Core consumer prices increased on a year earlier for 6 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.

Japan's real GDP in the April-June period grew by 2.5 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates). Viewed by demand item, although contribution of overseas demand was negative for the first time in 6 quarters, domestic demand such as private consumption expenditure, business fixed investment and public investment led the economy as a solid driving force.

Although business fixed investment, which was a main reason for the downward revision from the figure 4.0 per cent in the first preliminary estimates to the current 2.5 per cent, it is considered that investment maintains its firm increasing trend. Accordingly, there is no alteration in the JRI view that Japan's economic activity continues to be on a recovery trend, driven by domestic demand.

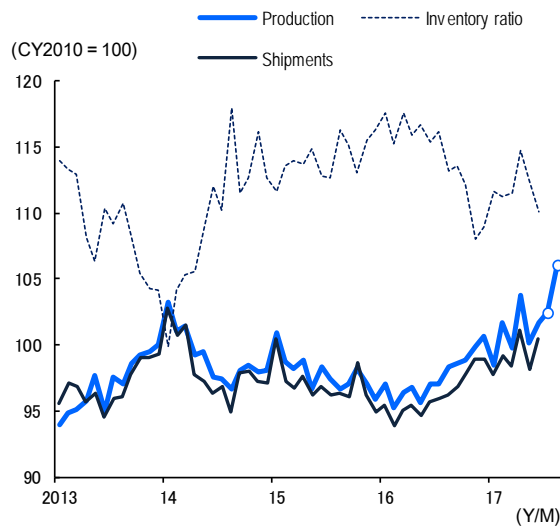
◆ Exports show signs of gaining momentum again and the household sector is expected to recover mildly

Based on monthly statistics, exports had slowed as shown in the deceleration in electronic parts due to slowing smartphone sales in China. Yet, exports have shown signs of gaining momentum again of late. For example, exports of automobiles to the US and exports of semiconductor manufacturing equipment to South Korea have risen.

Meanwhile, in the household sector, the recovery has spread to a wider range. With respect to the employment situation, the number of employees continues to increase and the unemployment rate stays at a low level. The active job openings-to-applicants rose to 1.52 times, the highest since February 1974, which exhibits that labour shortages have become more and more visible. However, wages have been very slow to increase, and the pace of recovery in household income stays modest.

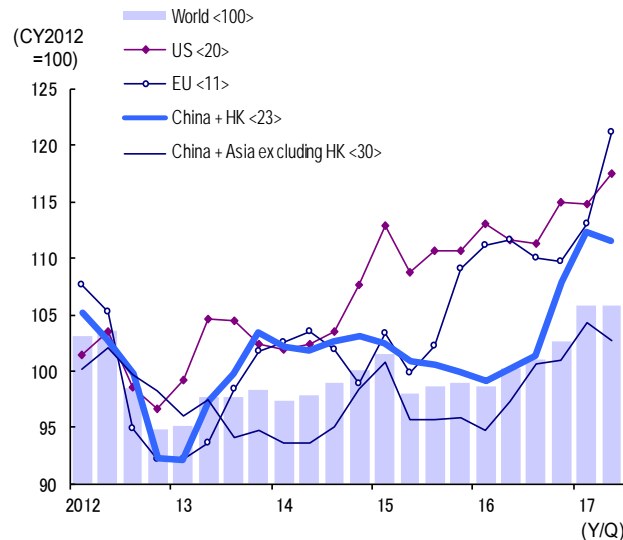
Against the background of continued improvement in employment and income environments, private consumption expenditure continues its moderate recovery trend, as shown in the fact that retail sales value rose by 1.9 per cent year-on-year in July, a rise for the ninth consecutive month.

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



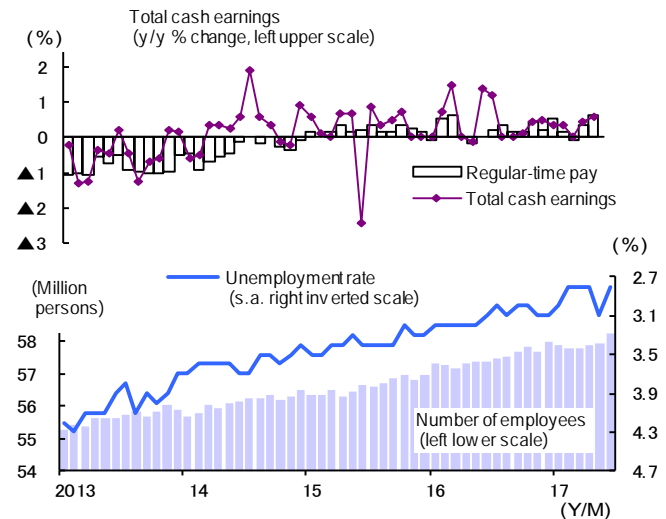
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Economy, Trade and Industry.
Note: The latest two figures in production are based on the production forecast index.

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



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angle brackets show the shares in FY2016.

Figure 2-3 Income and Employment-related Indicators



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

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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 value spent in Japan by foreign tourists during the April-June period was 1.77 trillion yen, up 13 per cent on a year earlier. With the weaker yen, the number of foreign tourists to Japan climbed by over 20 per cent. Also, the value spent per tourist has narrowed its year-on-year decline.

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

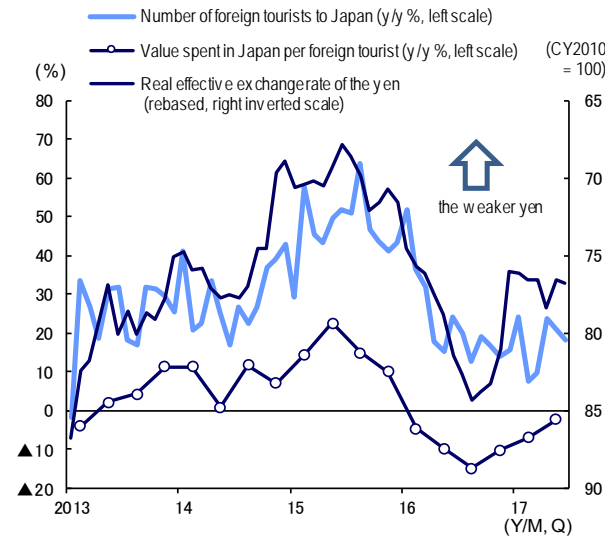
Then, observing overseas demand more widely by goods, it is obvious that the pace of rise in exports of electronic parts and devices, which had increased rapidly since the second half of last year, has slowed of late. Judging from the forecasts of

World Semiconductor Trade Statistics (WSTS), it is possible, in the short term, that worldwide demand for semiconductors could enter the adjustment phase.

However, in the medium and long term, it is predicted that Japan's exports of electronic parts and devices will likely stay firm, driven by an expanding demand due to a further spread of such uses as cloud computing services, IoT(Internet of Things), and an incorporation into automobiles. 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.

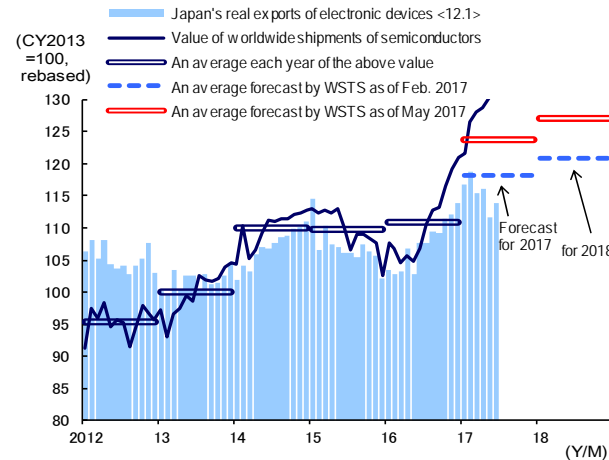
Yet, the pace of the pickup in exports will likely remain moderate. This tendency is due to the fact that more Japanese enterprises have come to meet the increased overseas demand for their products by expanding production in their overseas facilities, as the shift of production facilities to overseas 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 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.

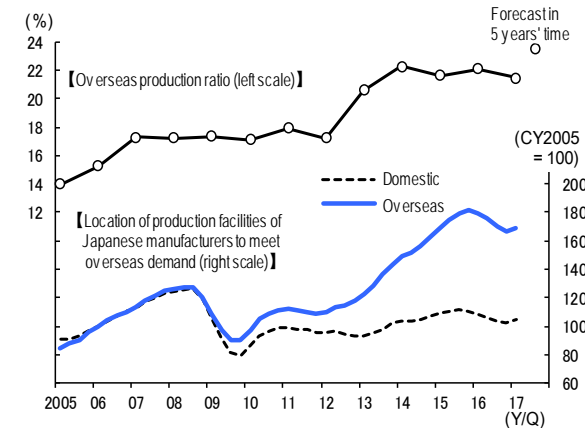
Figure 3-2 Value of Worldwide Shipments of Semiconductors and Japan's Real Exports of Electronic Devices



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

Corporate profits in Japanese enterprises are going well. As for sales value, a rise has been 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.

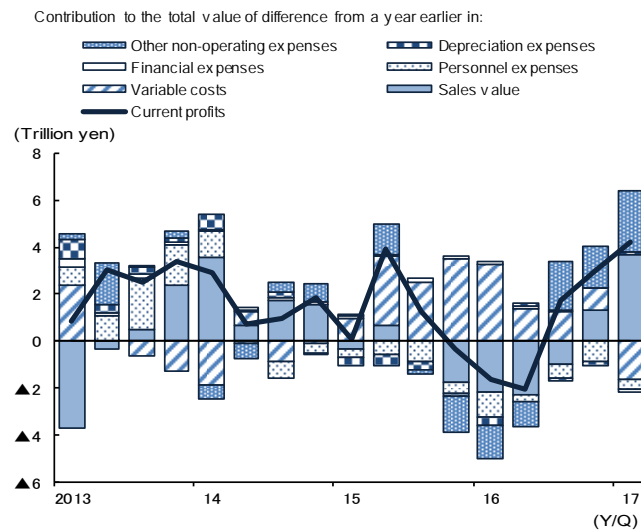
◆ Income and business investment will likely pick up mildly

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. Meanwhile, 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, 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.

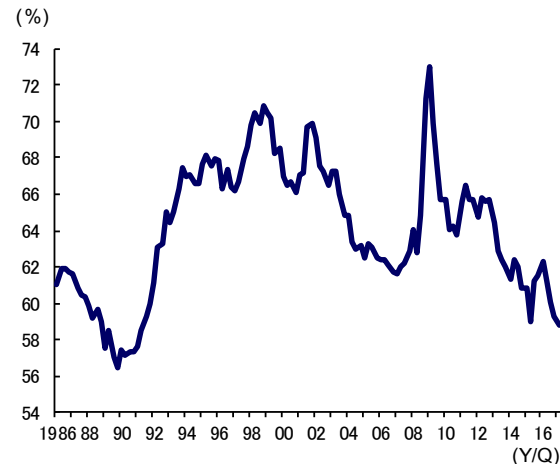
Figure 4-1 Contributions of Factors to the Total Value of Difference from a Year Earlier in Current Profits



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>

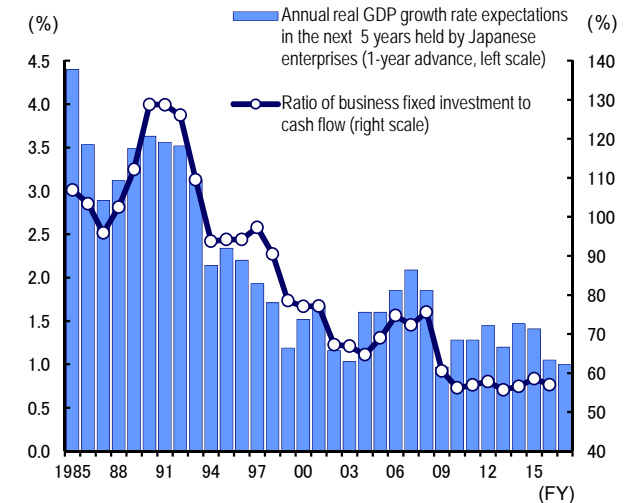


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

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 environments are on a mild improvement trend, as shown in the fact that the active job openings-to-applicants ratio in regular staff topped 1.0 in June.

However, average wages have been very slow to increase, although the wages in industries where a shortage of workers has been especially serious such as transport and construction are on the rise.

Analysed by size of enterprise, first, it is mainly small enterprises that have raised 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 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.

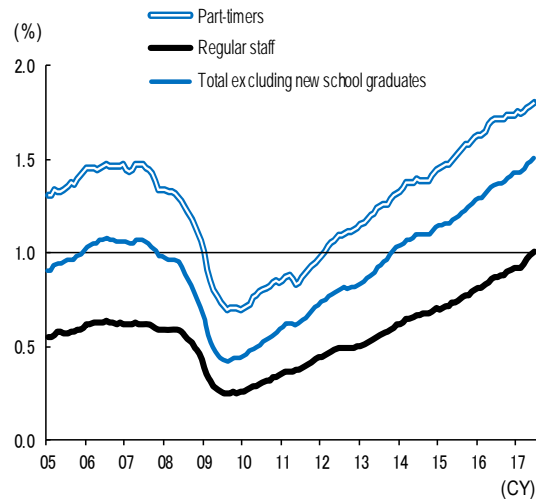
◆ Slow pace of recovery in real income will likely continue

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 average wages will stay slow. Against the background of the low rate of wage increases in the wage negotiation results this spring, an improvement in regular-time pay this year will likely stay modest. 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 become felt in year-end bonuses.

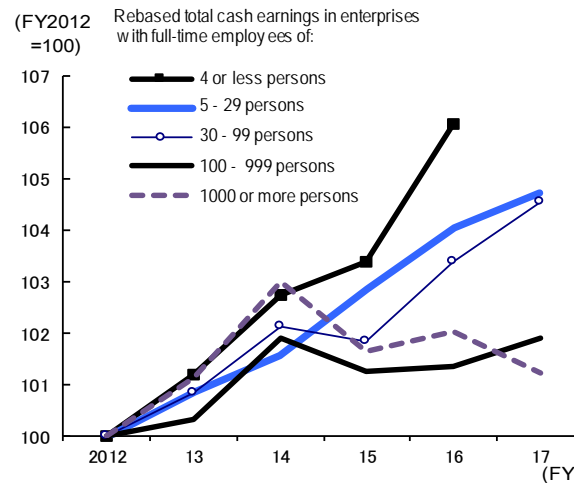
Meanwhile, the year-on-year change rate in consumer prices has turned positive, due to energy price rises and the effect of the weaker yen. Unfavourably, this will likely add downward pressure on the real purchasing power of households.

Figure 5-1 Active Job Openings-to-Applicants Ratio by Type <seasonally adjusted>



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

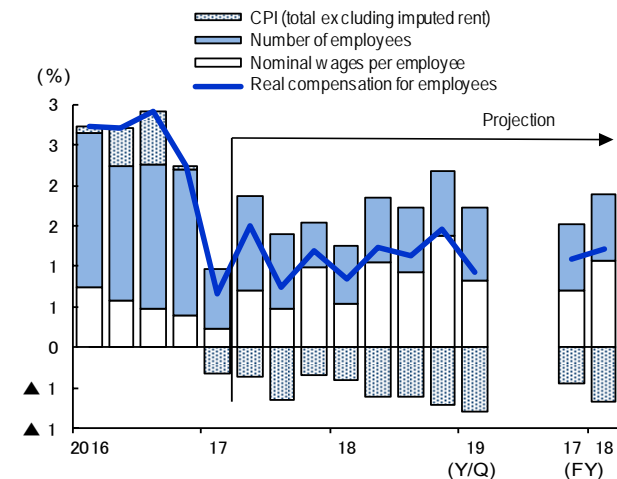
Figure 5-2 Total Cash Earnings in Full-Time Workers by Size of Enterprises <rebased>



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 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 has 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 firm stock prices 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

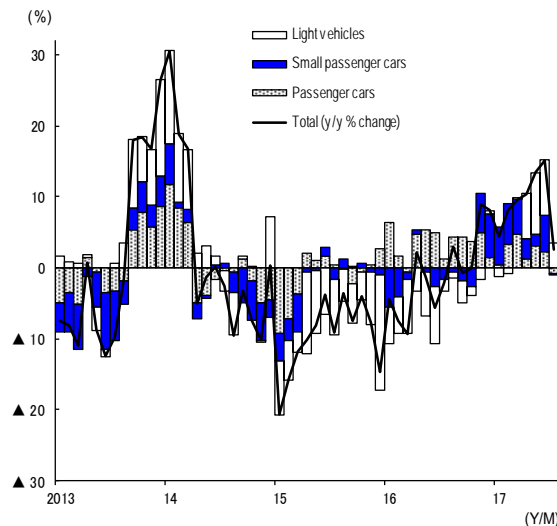
Looking ahead, the continued improvement in employment environments will likely go on bolstering the recovery in private consumption expenditure. However, the pace

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 the younger generation powerfully, and 2) this cohort of consumers tends to be economical against the background of anxiety about their future. It is also added that 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.

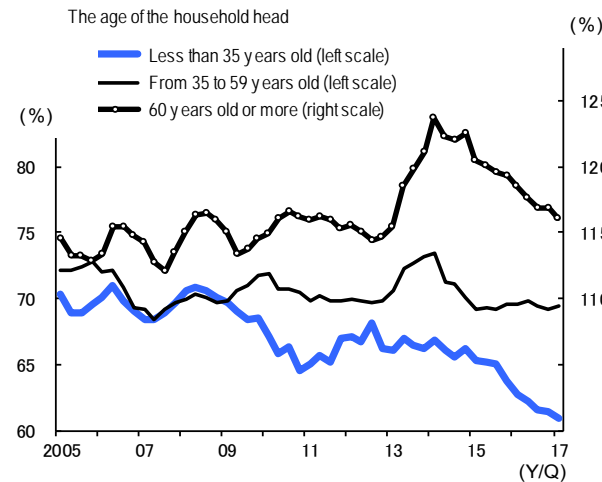
With respect to the cohort where the head of household is 60 years old or more, it is predicted that, especially, the year-on-year rise in consumer prices, albeit to a slight extent, will weigh on their consumption expenditure.

Figure 6-1 Number of Automobiles Sold <year-on-year % change>



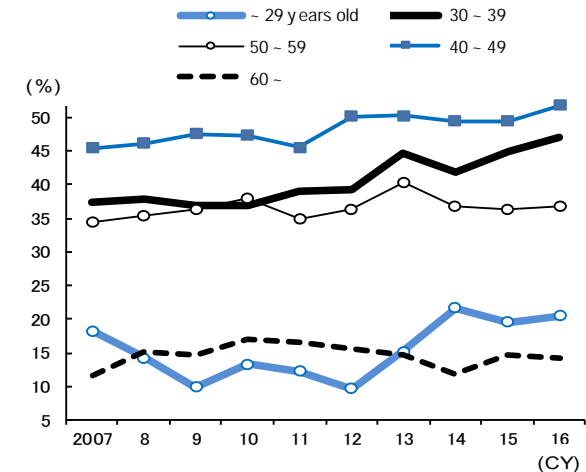
Source: The Japan Research Institute, Ltd. based on the data of Japan Automobile Dealers Association, Japan Light Vehicle and Motorcycle Association.

Figure 6-2 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 6-3 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; 1.5% 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) Japan's real GDP in the April-June period this year grew by 2.5 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates). Viewed by demand item, although the contribution of net exports (overseas demand) was negative for the first time in 6 quarters, domestic demand such as private consumption expenditure, business fixed investment and public investment led the economy as a solid driving force.

As for business fixed investment, which was a main reason for the downward revision from the figure 4.0 per cent in the first preliminary estimates to the current 2.5 per cent, it is considered that investment in plants and equipment still maintains its firm increasing trend on a quarterly basis. Accordingly, there is no alteration in the JRI view that Japan's economic activity continues to be on a recovery trend, driven by domestic demand.

(2) Looking ahead, it is predicted that the pace of economic growth will slow down on a quarterly basis toward the end of FY2017, reflecting the following. These are that 1) the pace of increase in private consumption expenditure will likely decelerate, especially in Q3 this year. Some factors could have a negative affect such as a decrease in automobile sales through the petering out of the renewal effects, and a pause in the rising trend in stock prices caused by the heightened geopolitical risk due to growing tensions with DPRK. In addition, these also contain the estimate that 2) the quarterly boosting effect of economic measures of the government on public investment will have already peaked.

However, it is unlikely that the economic recovery trend will falter mainly for the following reasons. These are that 1) factors such as the building up of a necessary level of inventory again, buoyant domestic construction investment in nonmanufacturing driven by redevelopment projects in the metropolitan areas as well as necessary accommodations for the rising number of foreign tourists to Japan, and firm investment for R&D chiefly in manufacturing. Also these include the prediction that 2) Japan's exports will likely be back to a rising trend again, reflecting reinvigorated attitudes worldwide towards business fixed investment. Accordingly, all in all, it is projected that real GDP in FY2017 will grow by 1.5 per cent.

(3) With respect to economic activity in FY2018, it is predicted that the trend of recovery will be sustained and real GDP will likely grow at a pace slightly over Japan's potential output growth rate, which is currently estimated to be roughly in the range of 0.6 to 1.0 per cent. Namely, it is projected that real GDP in FY2018 will grow by 1.1 per cent.

This is because Japan's exports will likely be supported by a firm pace of overseas economic growth, mainly led by US and Chinese economies. At the same time, it is predicted that domestic demand will continue to be firm against the background of an increase in business fixed investment affected positively by buoyant corporate profits, demand for construction relating to the 2020 Tokyo Olympic and Paralympic Games and redevelopment in the metropolitan areas, and continued improvement in employment and income environments owing to labour shortages.

◆ 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 and communication charges continue to fall, a rise in energy prices has pushed 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 against the background such as an improvement in supply-demand conditions on an aggregate basis. 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 wage rises will likely continue to lack strong enough momentum.

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

	CY2016	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)			
		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)	(Actual)		(Projection)	(Projection)				(Projection)	(Actual)	(Projection)		
Real GDP	1.6	1.2	2.5	1.2	0.9	0.8	1.0	1.3	1.3	1.2	1.3	1.5	1.1	
Private Consumption Expenditure	0.5	1.5	3.4	0.2	0.6	0.8	0.7	0.7	0.8	0.8	0.7	1.4	0.7	
Housing Investment	0.9	4.0	5.1	▲ 0.3	▲ 3.2	▲ 0.4	0.5	0.6	0.8	0.8	6.6	2.3	▲ 0.1	
Business Fixed Investment	8.1	2.1	2.1	1.8	2.4	2.8	3.0	3.0	2.9	2.9	2.5	2.6	2.8	
Private Inventories (percentage points contribution)	(▲ 0.7)	(▲ 0.6)	(▲ 0.1)	(0.8)	(0.6)	(▲ 0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.4)	(▲ 0.1)	(0.1)	
Government Consumption Expenditure	0.1	▲ 0.2	1.6	0.9	1.1	1.1	1.1	1.2	1.2	1.2	0.4	0.8	1.1	
Public Investment	▲ 9.2	1.5	26.1	4.3	▲ 5.1	▲ 3.5	▲ 2.8	2.0	1.2	▲ 1.2	▲ 3.2	4.9	▲ 1.2	
Net Exports (percentage points contribution)	(1.3)	(0.5)	(▲ 1.2)	(▲ 0.2)	(▲ 0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.8)	(▲ 0.0)	(0.1)	
Exports of Goods and Services	13.1	8.0	▲ 1.9	2.0	2.2	2.5	2.7	2.8	2.8	2.8	3.2	3.8	2.6	
Imports of Goods and Services	5.5	5.4	5.7	3.2	2.9	2.0	2.2	2.2	2.2	2.1	▲ 1.4	4.1	2.3	
(Ref.) Domestic Private Demand (percentage points contribution)	(0.8)	(0.7)	(2.3)	(1.2)	(1.2)	(0.7)	(0.9)	(0.9)	(0.9)	(0.9)	(0.6)	(1.2)	(0.9)	
(Ref.) Public Demand (percentage points contribution)	(▲ 0.4)	(0.0)	(1.4)	(0.4)	(▲ 0.0)	(0.0)	(0.1)	(0.3)	(0.3)	(0.2)	(▲ 0.1)	(0.4)	(0.2)	

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	1.6	0.7	1.0	1.6	1.5	1.9	1.4	1.5	1.6	1.9	1.1	1.5	1.6
GDP deflator	▲ 0.1	▲ 0.8	▲ 0.4	▲ 0.0	▲ 0.0	0.6	0.4	0.5	0.5	0.6	▲ 0.2	0.0	0.5
Consumer Price Index (excluding fresh food)	▲ 0.3	0.2	0.4	0.7	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	111	112	112	113	113	114	114	108	112	114
Import Price of Crude Oil (US\$/barrel)	46	55	53	51	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.