

Monthly Report of Prospects for Japan's Economy

October 2017

Macro Economic Research Centre
Economics Department



The Japan Research Institute, Limited

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

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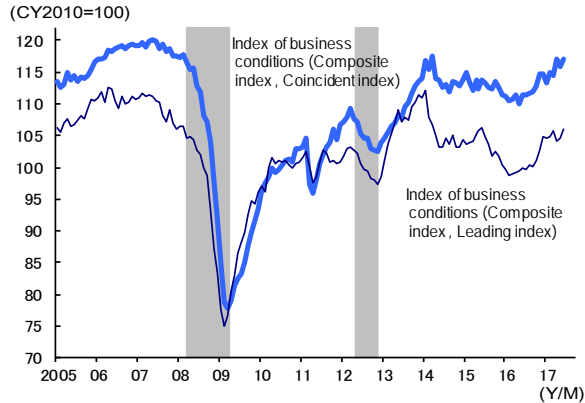
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The general situation of Japan's economy – Economic activity continues its mild recovery trend

Figure 1-1 Economic Activity

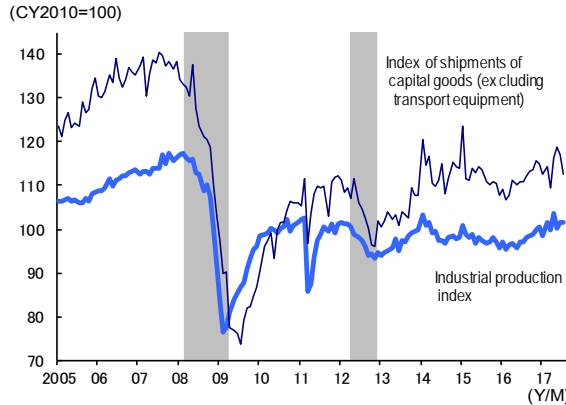
The coincident index rose for the first time in 2 months, due to an increase in shipments of producer goods and durable consumer goods.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

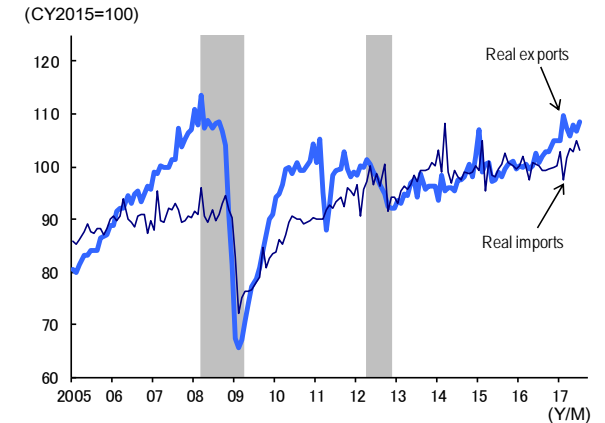
The production index has maintained its increasing trend on the whole, albeit while moving up and down. Shipments of capital goods fell for 2 months running.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

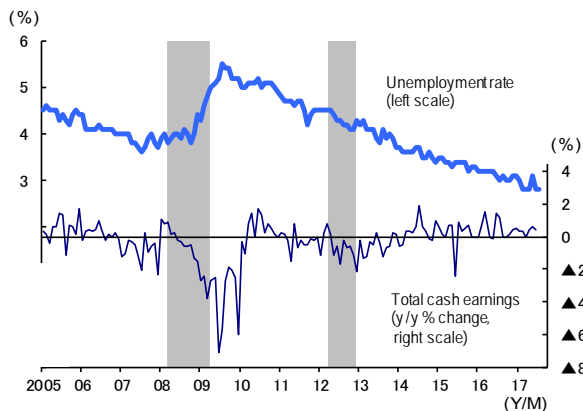
Exports to destinations such as the US and Asia increased. Imports decreased for the first time in 2 months.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate stays at a low level. As for total cash earnings, regular-time pay continues its year-on-year increase.

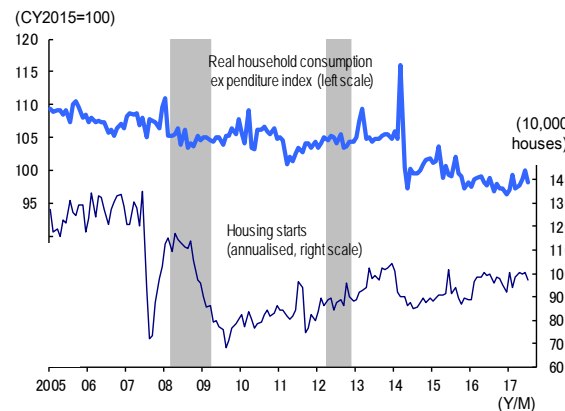


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

* The shaded area indicates the phase of recession.

Figure 1-5 The Household Sector

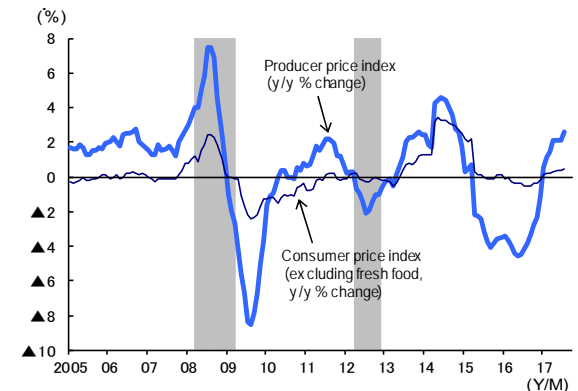
Household consumption expenditure has shown signs of recovery. Housing starts declined especially houses for rent and in which the owners will reside.



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 pace of year-on-year increase both in producer prices and in core consumer prices accelerated (slightly in the latter), reflecting the pickup in the crude oil price.



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 the 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.

While business fixed investment became a main reason for the downward revision in the total growth rate from the figure 4.0 per cent in the first preliminary estimates to the current 2.5 per cent, still 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.

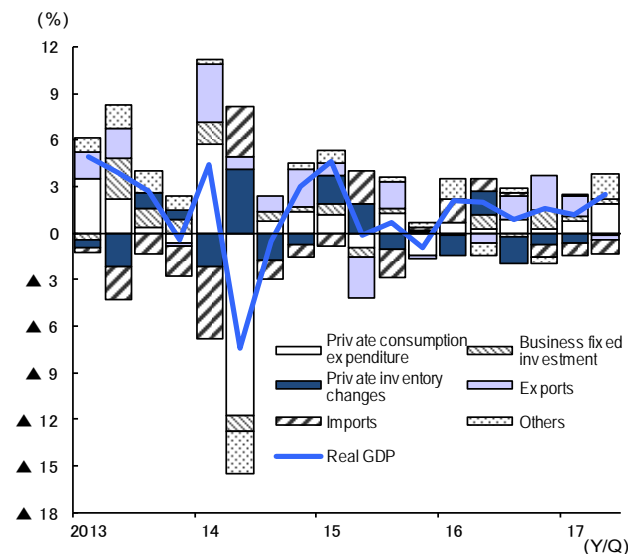
◆ Exports show signs of gaining momentum again and the household sector is expected to recover somewhat

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 goods such as automobiles to the US and 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 slow to increase, and the pace of recovery in household income stays modest.

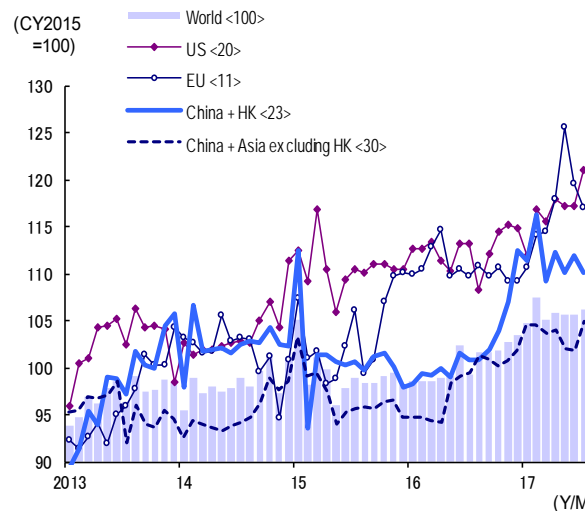
Against the background of continued improvement in employment and income environments, private consumption expenditure continues its moderate recovery trend, as shown in the fact that retail sales value rose by 1.9 per cent year-on-year in July, a rise for the ninth consecutive month.

Figure 2-1 Real GDP Change Rate by Demand Item <the second preliminary estimates, on an s.a. annualised q/q change basis>



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

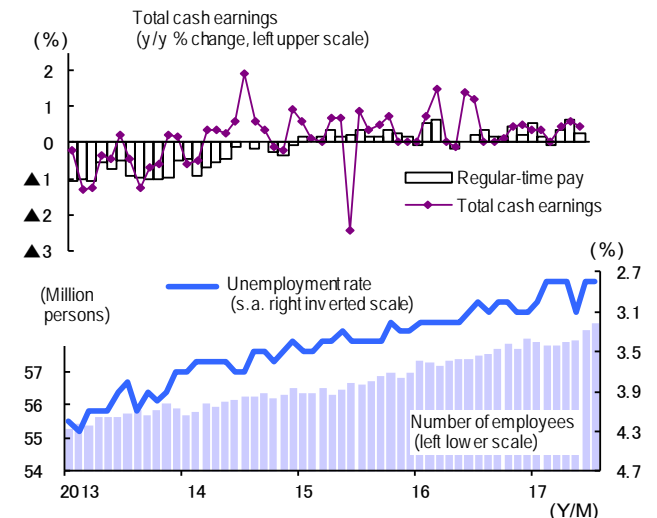
Figure 2-2 Real Exports by Destination <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The 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 number of foreign tourists to Japan climbed to 2.68 million in July, up 16.8 per cent on a year earlier. Owing to the weaker yen after last November, the year-on-year decline in the value spent per tourist has narrowed to the level slightly below zero. Looking ahead, inbound demand will likely stay firm, taking into account factors such as 1) income among people in Asian emerging countries goes on increasing, and 2) necessary environments for foreign tourists such as accommodations are likely to improve further in Japan.

◆ Japan's exports of goods will likely continue to rise, albeit moderately

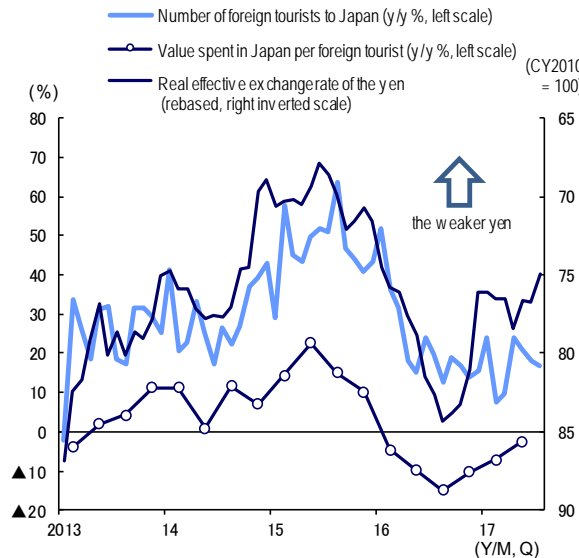
Then, observing overseas demand more widely by goods, it is obvious that Japan's exports of electronic parts and devices, which had driven the total exports forcefully since the second half of last year, have seesawed of late. Judging from the forecasts of World Semiconductor Trade Statistics (WSTS), 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.

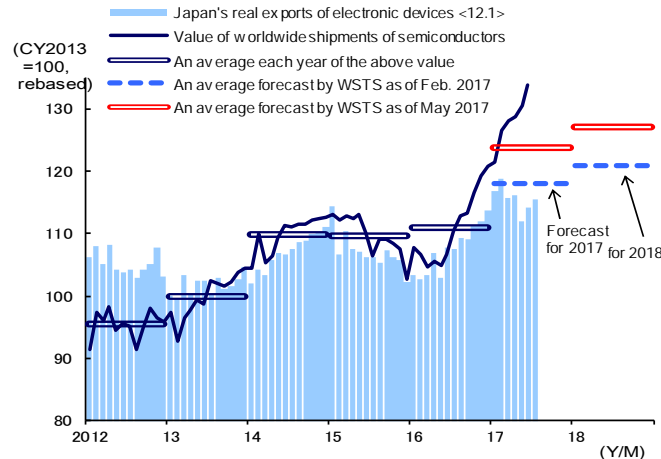
Yet, the pace of the pickup in exports will likely remain moderate. This tendency is due to the fact that more Japanese enterprises have come to meet the increased overseas demand for their products by expanding production in their overseas facilities, as the shift of production facilities to overseas sites has advanced. Also, there is possible risk that exports could have a downswing, if the yen strengthens significantly due to uncertainties such as the policy management exercised by the Trump administration and growing tensions with DPRK .

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.

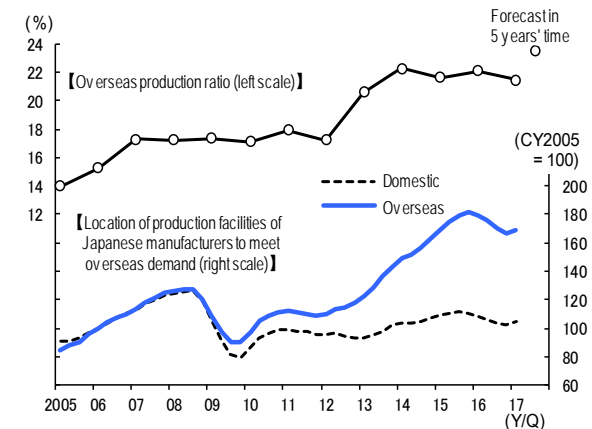
Figure 3-2 Value of Worldwide Shipments of Semiconductors and Japan's Real Exports of Electronic Devices



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 brackets 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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With corporate profits continuing to be buoyant, business fixed investment will likely pick up

◆ Corporate profits have shown firmness

Corporate profits in Japanese enterprises continue to go well.

Based on the Financial Statements Statistics of Corporations by Industry, the April-June period 2017 saw an increase of 1.0 per cent in sales value on an s.a. quarter-on-quarter basis, a rise for 4 quarters running. Some factors such as firm new automobile sales and the pickup in inbound demand contributed to the climb. Furthermore, current profits increased by 4.0 per cent on the same q/q basis, resulting in the highest ever value in 3 quarters in a row.

In addition to good sales, it has also contributed to buoyant profits 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 and dividends from investments, which is sent by overseas subsidiaries, has increased.

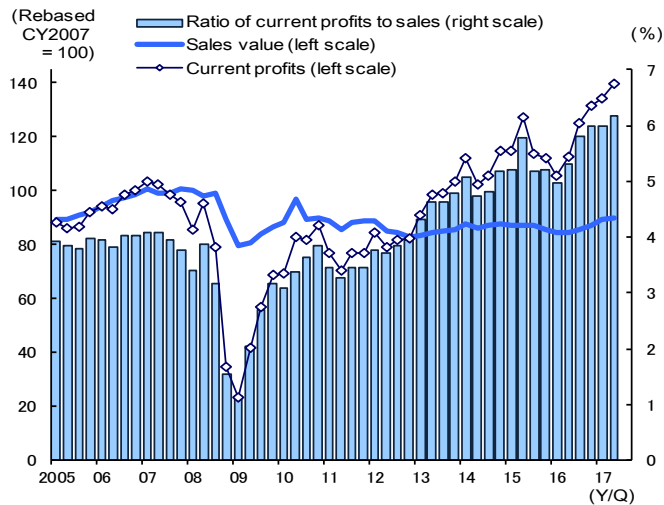
Thus, good profitability in Japanese enterprises has been maintained. Therefore, corporate profits are highly likely to continue to be firm for the time being.

◆ Income and business investment will likely pick up mildly

As Japanese enterprises maintain their cautious attitudes to an increase in personnel expenses, labour's relative share in total value added has fallen to the lowest level since year 1991. However, taking into account facts such as 1) a sense of labour shortages comes to be felt more and more strongly, and 2) corporate profits will likely continue to improve, the pace of rise in average wages is predicted to accelerate gradually.

As for business fixed investment, attitudes of enterprises still remain cautious, under the circumstances in which a lot of uncertainties surrounding the overseas situation are left persistently. Yet, as cash held by enterprises per se is abundant, demand for investment in plants and equipment is estimated to be basically solid, especially in some types of investment such as investment for rationalisation and saving, and investment for construction of facilities like accommodations. Therefore, it is expected that business fixed investment will pick up, as excessive anxieties over the overseas situation, which are currently held by enterprises, ease gradually.

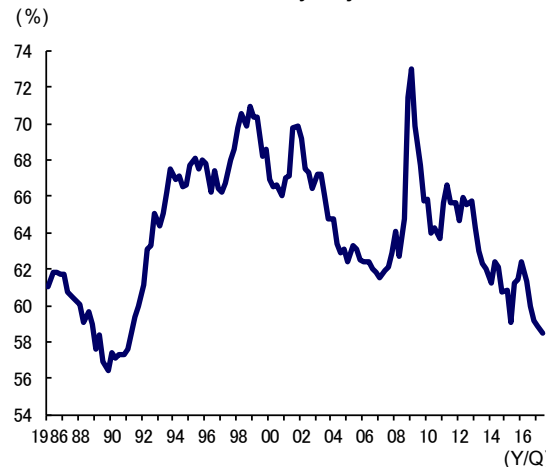
Figure 4-1 Sales Value and Ratio of Current Profits to Sales <seasonally adjusted>



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>

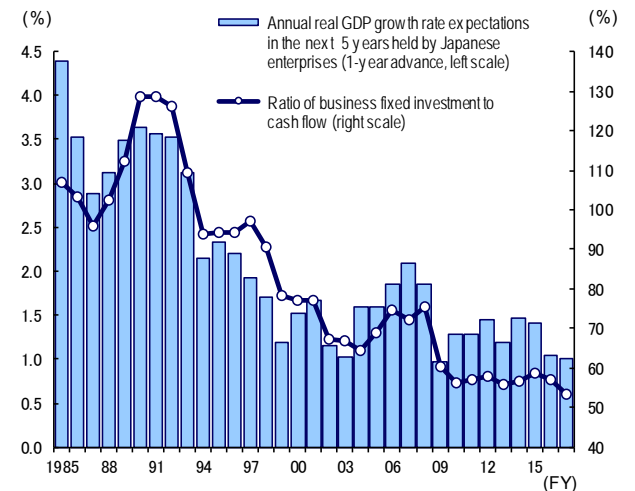


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

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 slow

◆ Average wages have been 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 has topped 1.0 since June. However, average wages have been slow to increase, even though 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, first, it is mainly small enterprises that have raised wages. Yet, in this size of enterprises, the level of average wages has been relatively low and the number of employees has not increased much. Second, in larger enterprises, 1) the average rate of wage rises in negotiations this spring was almost the same as last year, with large enterprises being conscious of future uncertainties over, 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. As it stands, the pace of rise in the

average wages has slowed further after the start of FY2017.

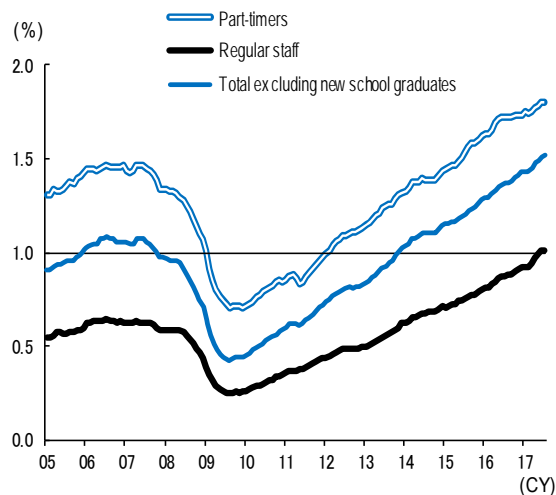
◆ Slow pace of recovery in real income will likely continue

Looking ahead, the improvement in employment environments will likely continue, against the background of mild recovery in economic activity.

However, as for wage rises, it is predicted that the pace of rise in average wages will stay slow. Reflecting the fact that the wage increase rate in negotiations this spring stayed as low as last year, an improvement in regular-time pay this year will likely remain modest to the end of FY2017. 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, encouragingly, the boosting effect on corporate profits stemming from the weaker yen after last November is likely to become felt in year-end bonuses.

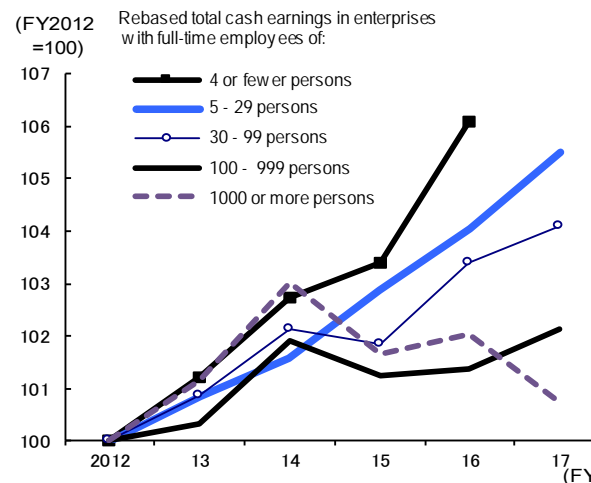
Meanwhile, the year-on-year change rate in consumer prices has turned positive, due to energy price rises and the effect of the weaker yen. Unfavourably, this will likely add downward pressure on the real purchasing power of households.

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.

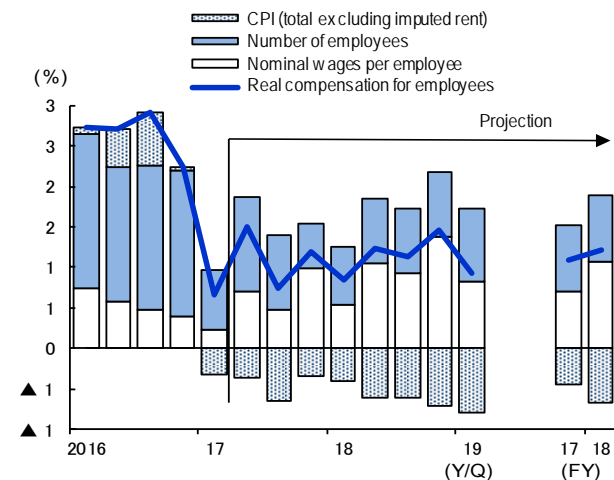
Figure 5-2 Total Cash Earnings in Full-Time Workers by Size of Enterprises <rebased>



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 albeit with the slowing of late, as renewal has positive effects, and also the fallout of sales suspension due to the falsifying of fuel economy data by a light vehicle manufacturer has 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. Firm stock prices 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

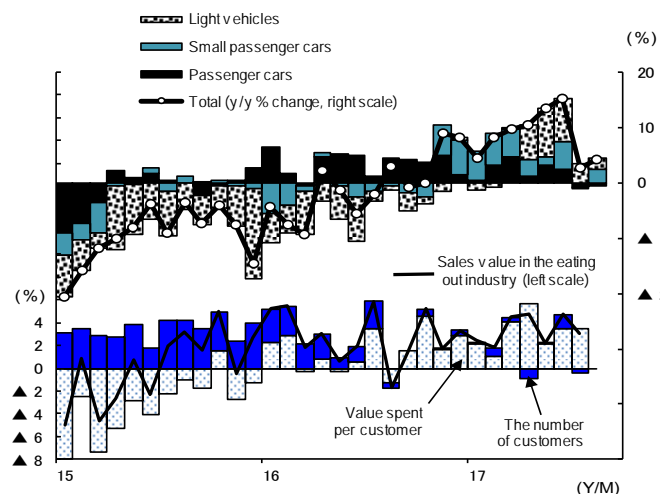
of the pickup in consumption is highly likely to remain slow.

One of the main reasons is that both a 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.

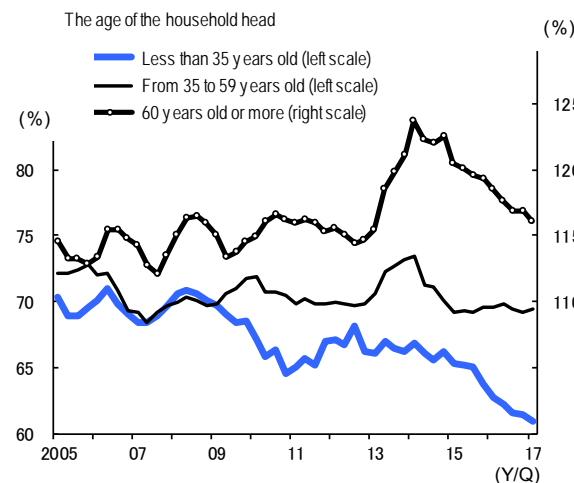
With respect to the cohort where the head of household is 60 years old or more, it is predicted that, especially, the year-on-year rise in consumer prices, albeit to only a slight extent, will weigh on their consumption expenditure.

Figure 6-1 Number of Automobiles Sold and Sales Value in the Eating Out Industry <year-on-year % change>



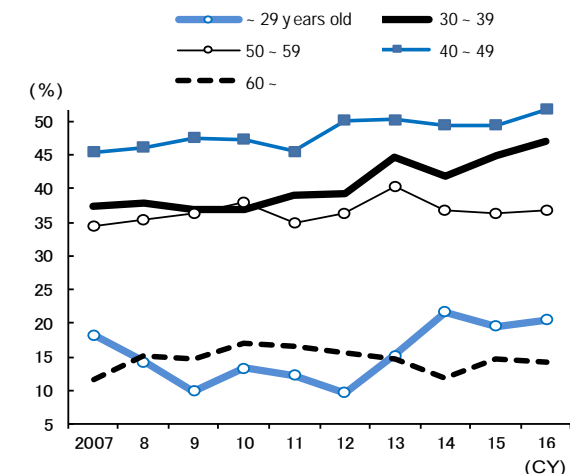
Source: The Japan Research Institute, Ltd. based on the data of Japan Automobile Dealers Association, Japan Light Vehicle and Motorcycle Association, Japan Food Service Association (JF).

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 due to 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 related 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.