Monthly Report of Prospects for Japan's Economy

March 2018

Macro Economic Research Centre
Economics Department

The Japan Research Institute, Limited
http://www.jri.co.jp/english/periodical/

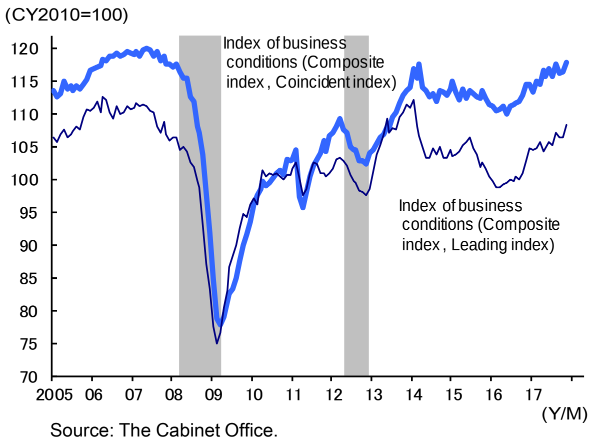
This report is the revised English version of the February 2018 issue of the original Japanese version.

Disclaimer:

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

Figure 1-1 Economic Activity

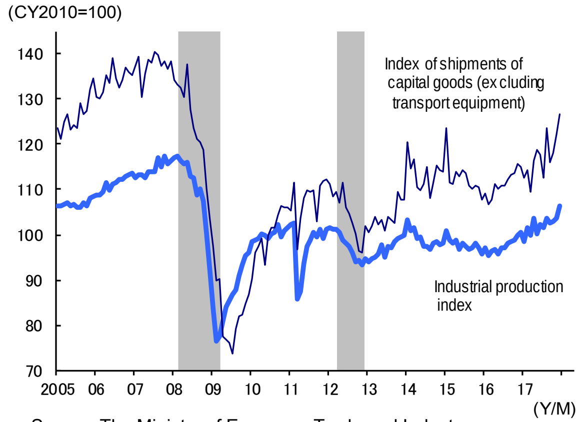
The coincident index rose to the highest level since October 2007, reflecting an increase in shipments of producer goods.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

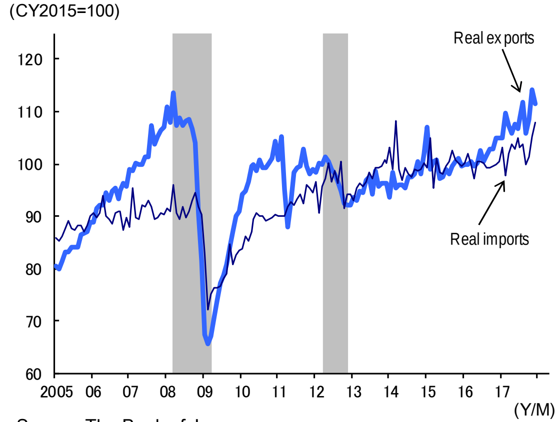
Both the production index and the index of shipments of capital goods have maintained the increasing trend on the whole, albeit with some ups and downs.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

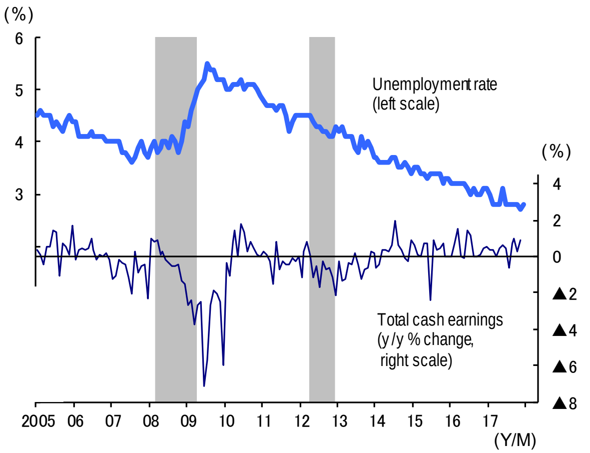
Real exports to destinations such as the US took a breather. Real imports increased for 3months in a row.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

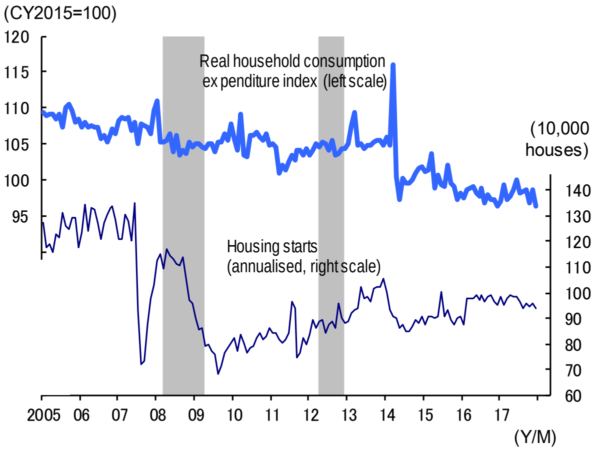
The unemployment rate stays at a low level. Total cash earnings continue a slight rise year-on-year on the whole.



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

Figure 1-5 The Household Sector

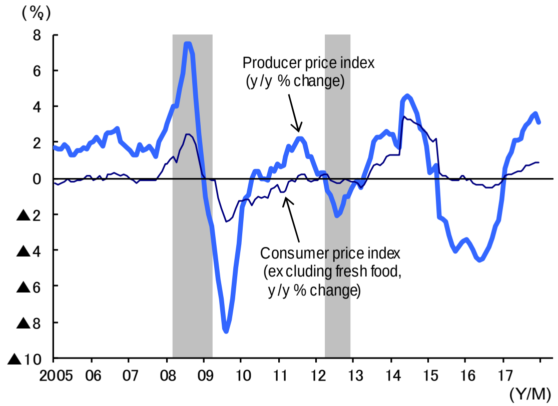
Household consumption expenditure has seesawed. Housing starts remain flat.



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

Both producer prices and core consumer prices continue to rise year-on-year, affected by the rise 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.

＊The shaded area indicates the phase of recession.

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The Japan Research Institute, Limited

Production increases in the corporate sector, as the household sector also recovers mildly

◆ Economic activity continues its recovery trend

Japan's real GDP in the October-December period 2017 grew by 0.5 per cent on an annualised quarter-on-quarter change basis (national accounts, the first preliminary estimates), a rise in 8 quarters running. Although the growth rate decelerated from Q3, private consumption expenditure and business fixed investment stayed firm, besides an increase in exports at a relatively high pace.

Thus, there is no alteration in JRI's view on current economic conditions that Japan's economic activity continues its recovery trend.

Meanwhile, based on the Economy Watchers Survey, the DI for current economic conditions in December was above 50, a diverging point between good and bad, for the fourth consecutive month.

◆ Production holds its rising track

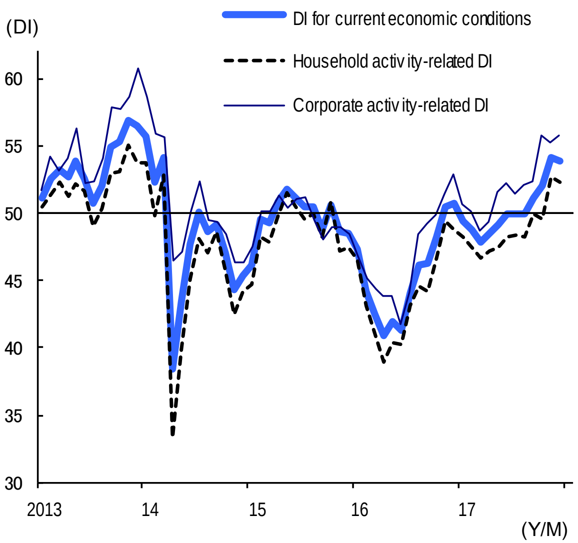
As for corporate activity, the industrial production index in December climbed by 2.9 per cent month-on-month, a rise for 3 months in a row. The indices in a wide range of industries increased, including automobiles and their parts, construction machinery, and so on. The production forecast index shows a considerable rise of 5.7 per cent for February after a downswing in January, which is estimated to be a continued increasing trend in production on the whole.

Japan's exports are on the rise. Viewed by destination and product, exports of semiconductor manufacturing equipment to Asia, mainly to China, climbed. Also, exports of automobiles to Australia increased, reflecting the end of local production of a large manufacturer.

◆ The household sector also shows a pickup

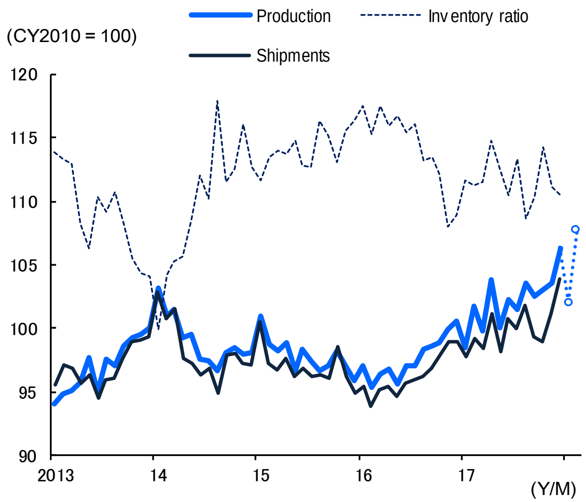
Based on the Family Income and Expenditure Survey (two-or-more person households) of The Ministry of Internal Affairs and Communications, real household consumption expenditure in December slightly declined by 0.1 per cent year-on-year. However, the figure excluding volatile house and automobile expenditure was +2.9 per cent on a year earlier. As employment and income environments continue to improve, even the private consumption figure in the above mentioned survey has come to show a pickup trend.

Figure 2-1 Economy Watchers Survey <seasonally adjusted>



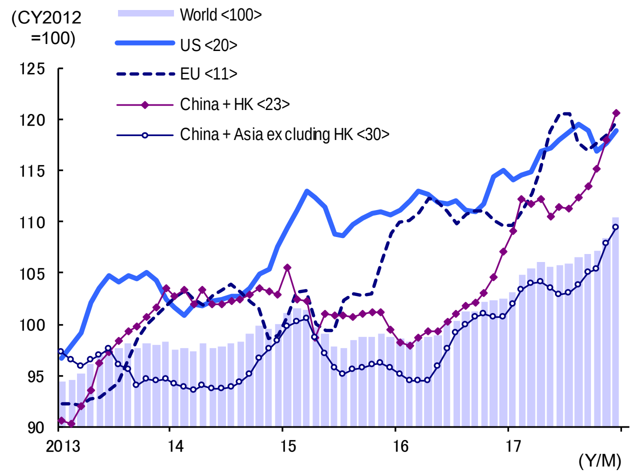
Source: The Cabinet Office.

Figure 2-2 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 2-3 Real Exports by Destination <seasonally adjusted, 3-month moving averages>



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.

Overseas demand is on the rise

◆ Inbound demand goes on picking up

Inbound demand stemming from foreign tourists to Japan continues its climbing trend. The annual value spent by foreign tourists in 2017 was 4.4 trillion yen, up 17.8 per cent from 2016. The number of foreign tourists to Japan during last year climbed to 28.7 million, up 19.3 per cent. Also, the value spent per tourist turned to a year-on-year increase in the second half of 2017.

Looking ahead, inbound demand will likely stay firm, taking into account factors such as income among people in Asian emerging countries continues to increase, and necessary environments for foreign tourists such as accommodations are likely to improve further in Japan.

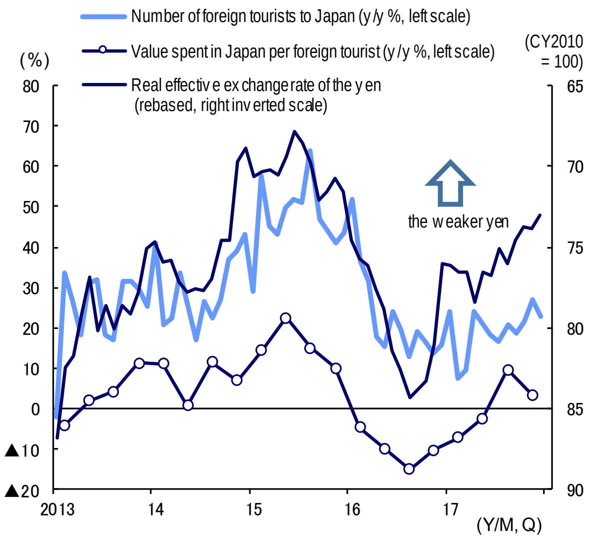
◆ Japan's exports of goods will likely continue their rising trend

The trade balance in 2017 was +3.0 trillion yen, with trade surpluses having shrunk by 25.2 per cent compared with last year. The reason for the shrinkage was a negative contribution of the import price rise due to factors such as the pickup in the crude oil price, the weaker yen, and so on. On the other hand, both export price and export volume contributed positively.

Regarding exports, the rising trend has been maintained, as global trade volume expands. Viewed by item, exports of electronic parts and devices as well as capital goods, of which worldwide demand has risen visibly, continue to be a driving force.

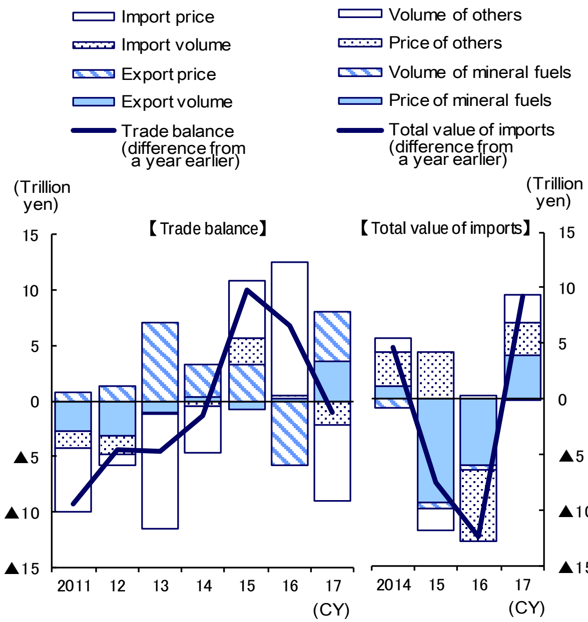
It is expected also in the future that exports of electronic parts and devices will keep their high pace. They will be driven by heightened demand for smartphones with higher quality, increased demand for data centres for cloud computing services, expanding demand for IoT(Internet of Things) and an incorporation into automobiles, and so on. In addition, exports of capital goods are very likely to stay solid, as production activity in manufacturers worldwide has become more and more brisk.

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



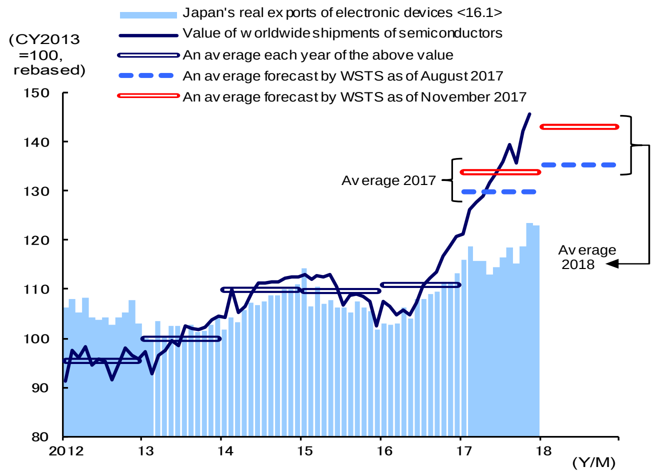
Source: The Japan Research Institute, Ltd. based on the data of The Japan Tourism Agency, The Bank of Japan.

Figure 3-2 Contributions to Difference in Value from a Year Earlier in Trade Balance



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

Figure 3-3 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), Semi-conductor 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.

With profits continuing to improve, business fixed investment is on a rising trend

◆ Corporate profits continue to improve

Corporate profits continue their improving trend. The ratio of current profits to sales has been at a higher level than that in the "bubble" boom period in the late 1980's.

Among contributing factors to profits, an increase in personnel expenses affected by deteriorating labour shortages has been a weighing factor.

However, profitability in Japanese enterprises has improved visibly, as a result of great efforts having been made such as the restructuring of their business. One of the fruits of the efforts is the fact that the break-even point ratio has fallen significantly. As a consequence, the situation appears to be where an increase in sales value leads to the pushing up of corporate profits directly.

Looking ahead, it is predicted that corporate profits will continue to be firm, as demand at home and abroad expands.

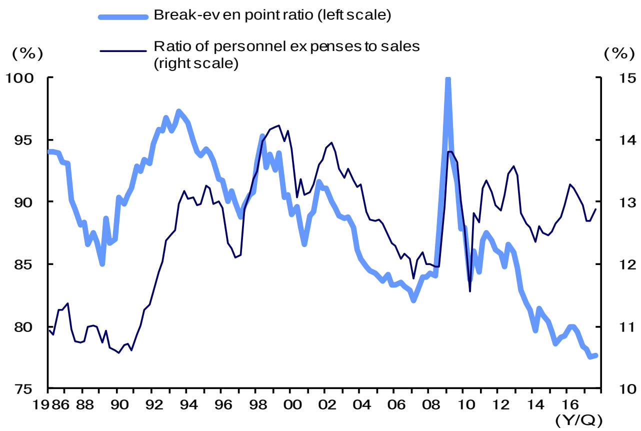
◆ Business fixed investment is on the rising trend

As for business fixed investment, as cash held by enterprises per se is abundant, it is projected that investment in plants and equipment, mainly investment for rationalisation and saving reflecting labour shortages, will increase.

Also, in certain fields where rapid growth of some products and services is expected, strategic investment has increased. First, construction investment such as in 1) accommodations in response to a climb in inbound (foreign tourist) demand, 2) logistics facilities with sophisticated functions to meet increasing demand due to an expansion in internet shopping, and 3) redevelopment projects in core cities such as metropolitan areas. Second, investment for research and development (R&D). Investment for R&D to encourage new technologies such as AI, IoT, and self-driving cars has bolstered total business fixed investment.

However, the spread of enterprises strengthening production capacity has still been limited, under the circumstances where, as a population reduces, a rise in growth expectations for domestic markets has yet to be seen.

Figure 4-1 Ratio of Personnel Expenses to Sales and Break-even Point Ratio



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

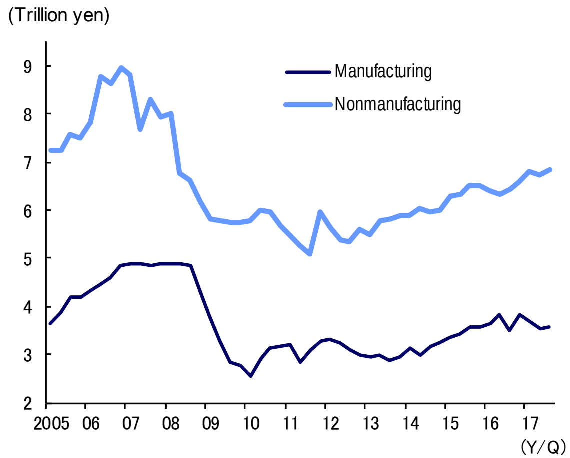
Note: The break-even point ratio = break-even point sales value / sales value

Break-even point sales value = fixed costs / (1 - (variable costs / sales value))

Fixed costs = personnel expenses + depreciation expenses + interest payment

Variable costs = cost of goods sold + selling and administration expenses - personnel expenses - depreciation expenses

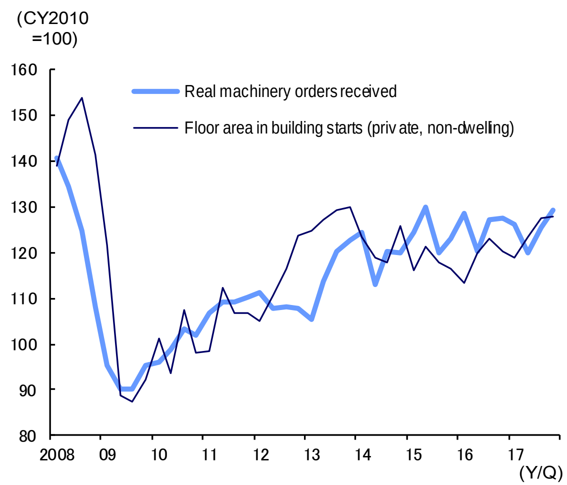
Figure 4-2 Value of Business Fixed Investment based on Financial Statements Statistics of Corporations by Industry <seasonally adjusted>



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

Note: All industries excluding financial institutions.

Figure 4-3 Leading Indicators for Business Fixed Investment <seasonally adjusted>



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

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

◆ Employment conditions continue to improve

Employment environments are on an improving trend. In the current economic expanding phase since November 2012, the number of employed persons continues to climb at the fastest pace since the "bubble" boom period during 1986 - 91. This is taking place even in the situation where a population 15 years of age or over has been flat. Labour input has also been on the rise since early 2014, led by regular-time employed persons.

As for wages, it is true that the wages in industries where a shortage of workers has been especially serious such as transport and construction are on the rise. However, analysed by size, it is mainly small enterprises, the average wages of which are relatively low, that have raised wages.

Analysed by industry also, it is mainly industries with relatively lower wages that have seen wage increases, such as 1) eating and drinking places, and accommodations, 2) health care and welfare, and 3) wholesale and retail trade. Accordingly, and regrettably, the boosting effects of the above mentioned on average wages are limited.

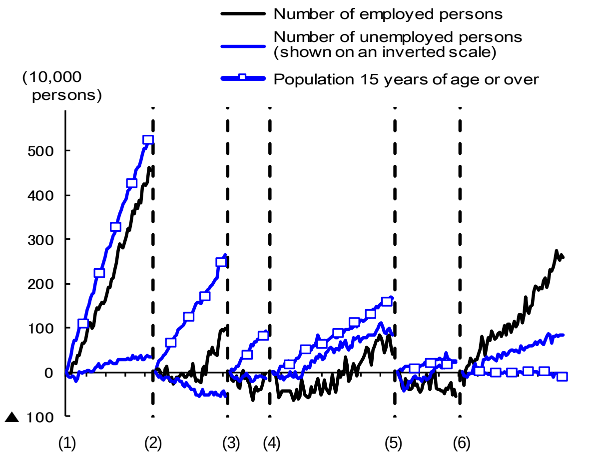
◆ Slow pace of recovery in real income will likely continue

Looking ahead, the improvement in employment environments will likely continue, against the background of the recovery in economic activity. Also, the pressure to raise wages is expected to strengthen reflecting continued labour shortages and good corporate profits. Further, as an atmosphere that wage rise momentum is growing spreads, it is expected that the rate of wage rises in the wage negotiations spring this year (FY2018) will be more than that in the result last spring (FY2017).

However, it should not be relied on that the acceleration in the rate of rise in wages up to 3 per cent, which is the target of the government, will be materialised in the wage negotiations this spring. In addition, the year-on-year change rate in consumer prices will stay positive, albeit slightly. Unfavourably, this will likely add downward pressure on the real purchasing power of households.

Thus, the pace of recovery in real income will likely continue to be moderate.

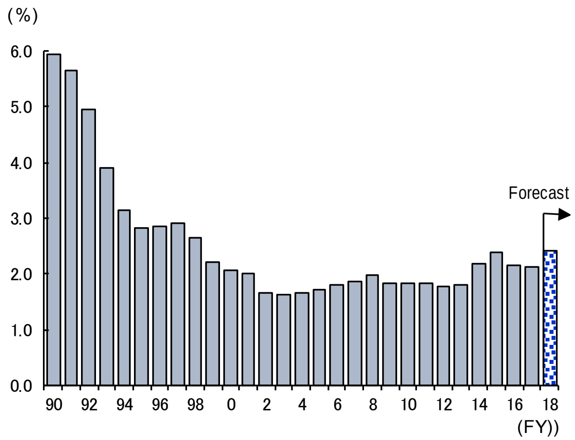
Figure 5-1 Employment-related Indicators by Economic Expanding Phase in the Past and Present



(1) 1986/11～1991/2 (2) 1993/10～1997/5 (3) 1999/1～2000/11
(4) 2002/1～2008/2 (5) 2009/3～2012/3 (6) 2012//11～

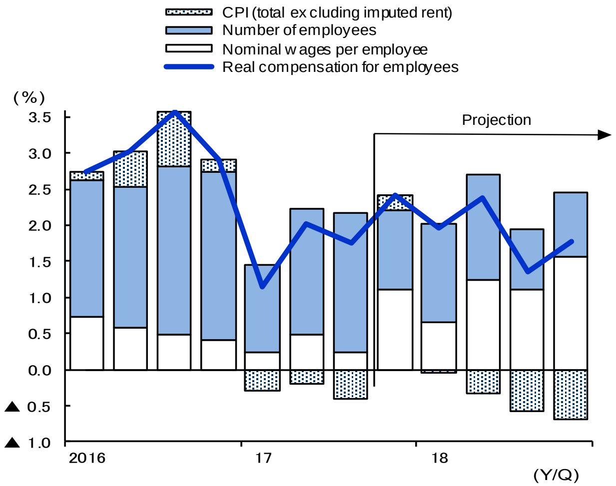
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Rate of Wage Rise Resulting from Wage Negotiations Each Spring



Source: The wage negotiation results each spring (mainly in large enterprises) released by The Ministry of Health, Labour and Welfare. Forecast by the JRI.

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.

Private consumption expenditure is likely to recover mildly

◆ Expenditure on durable goods has picked up

Based on the Consumption Activity Index by BoJ, expenditure on durable goods, which had weakened after last autumn, (mainly affected negatively by the improper pre-shipment inspection problem in automobiles), turned positive year-on-year again. Expenditure on services has accelerated, led by services such as communications, health care and welfare, eating out, etc. Further, in non-durable goods, an active trend in which enterprises try to secure sales increases through marketing new products has come to be seen again.

◆ Slow pace of recovery in private consumption will likely continue

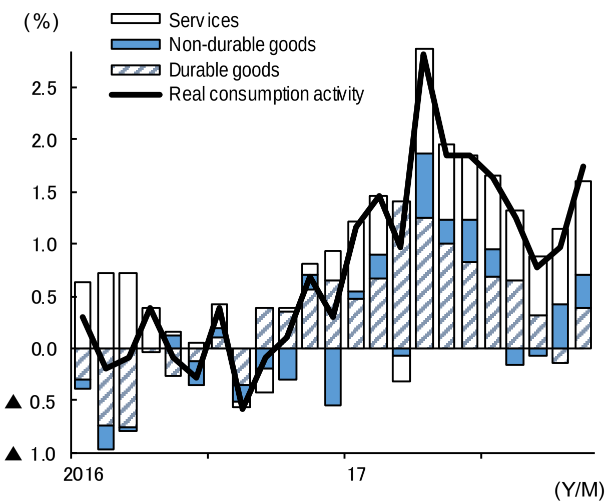
Looking ahead, the continued improvement in employment environments will likely go on bolstering the recovery in private consumption expenditure. However, consumer confidence has weakened slightly, partly due to the rise in the price of fresh food in winter. Also, a tone of corrections has been felt in the stock market from early February. Therefore, a further push to private consumption expenditure through the wealth effect cannot be relied on.

On the other hand, as a favourable aspect, income environments in the middle to lower income brackets have improved, reflecting factors such as a pause in the rise in the ratio of non-regular employees to the total and wage increases in medium and small-sized enterprises. Taking these elements into consideration, it is highly unlikely that private consumption expenditure will falter.

With respect to housing investment, it is predicted that it will be on a weakening trend for the time being. The value of new home loans, including value of new loans to individual owners for building rental apartments, has turned negative year-on-year.

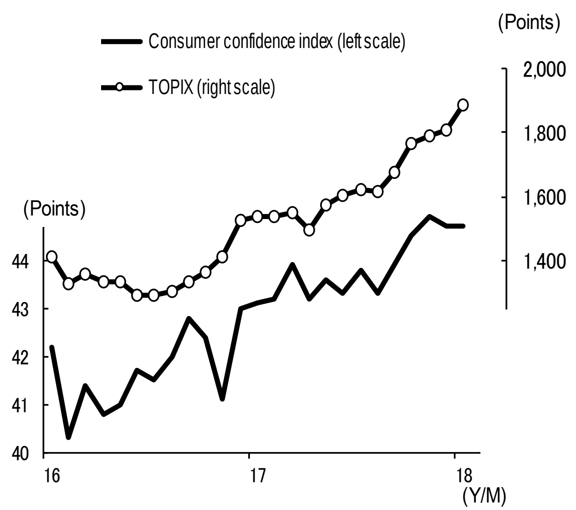
It is true that the situation of low interest rates continues as a supporting factor for housing investment. However, there are some daunting problems in housing investment for rental houses. These include the issue that 1) sub-lease problems have risen, where some owners of rental houses put their rental houses for sub-lease to intermediate real estate agents and then become involved in quarrels over collecting the rent, and 2) rental houses have been oversupplied, which has led to a surge in the rate of vacant apartments.

Figure 6-1 The Consumption Activity Index by Bank of Japan <year-on-year % change>



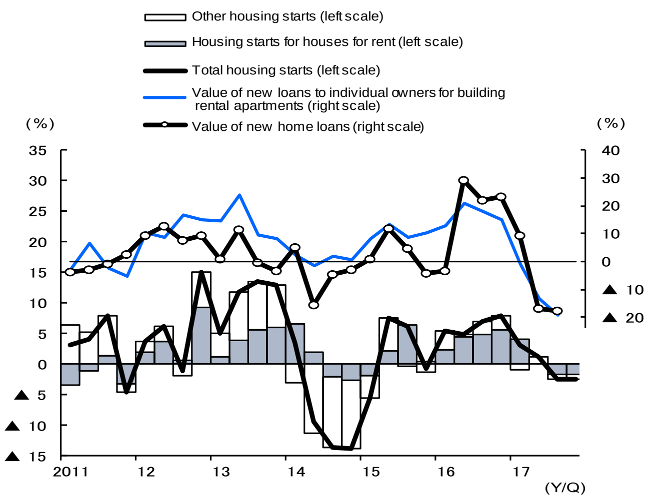
Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan.

Figure 6-2 Consumer Sentiment and Stock Prices



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

Figure 6-3 Value of New Loans for Building of Rental Apartments <year-on-year % change>



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

Topics : The effect of BoJ's ETF purchasing policy on stock prices

◆ BoJ's ETF purchasing policy has boosted stock prices

The Bank of Japan (BoJ) started the policy of the purchasing of ETFs in December 2010 in order to bolster the stock market. The aim of the policy is to contribute to achieving the goal of a 2 per cent year-on-year rise in the core CPI, through reinvigorating business fixed investment and private consumption expenditure, which are to be brought about by the improvement of business sentiment and environments for corporate financing by means of rising stock prices.

At present, the BoJ purchases about 6 trillion yen of ETFs annually. The accumulated market value of ETFs bought by the BoJ reached about 22 trillion yen at the end of 2017, which is equivalent to 3.2 per cent of the total market value of the first section in the Tokyo Stock Exchange.

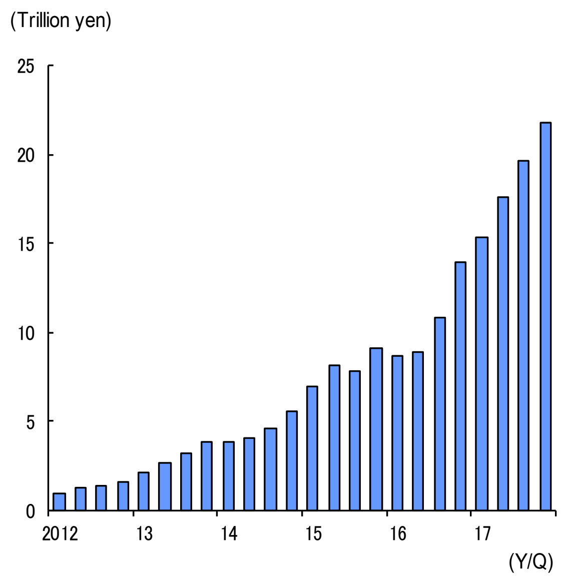
After the introduction of the policy, an upswing has been observed in stock prices from those calculated by fundamental factors such as the world economy and the exchange rates. Thus, it is estimated that a certain part of the upswing is due to the effect of BoJ's ETF purchasing policy. The JRI estimate shows that 22,765 yen, which was the Nikkei Average at the end of 2017, was boosted by around 1,900 yen through the ETF purchasing policy.

◆ The effect of the policy will likely continue to be relied on in the future

While it is estimated that the ETF purchasing policy has borne fruit to some extent, the 2 per cent core CPI inflation goal still has a long way to go. One of the reasons for the situation is that Japan's economic structure has changed to that where an expansion of economic activity does not bring about much of a rise in prices.

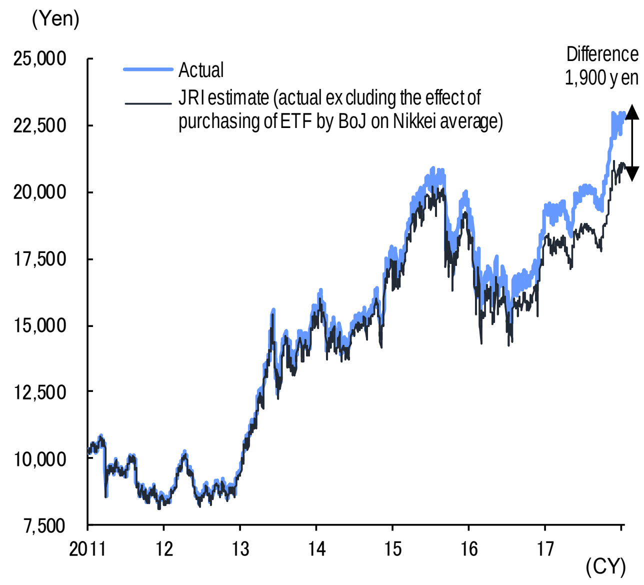
Even under the circumstances, the effect of BoJ's ETF purchasing policy per se will likely continue to be relied on in the future. If the BoJ continues to buy ETFs at the pace of 6 trillion yen per year, it is predicted that Japan's stock prices, for instance, the Nikkei Average, will be boosted by around 500 yen every year.

Figure 7-1 Accumulated Value of ETFs Purchased by BoJ (at the Current Price)



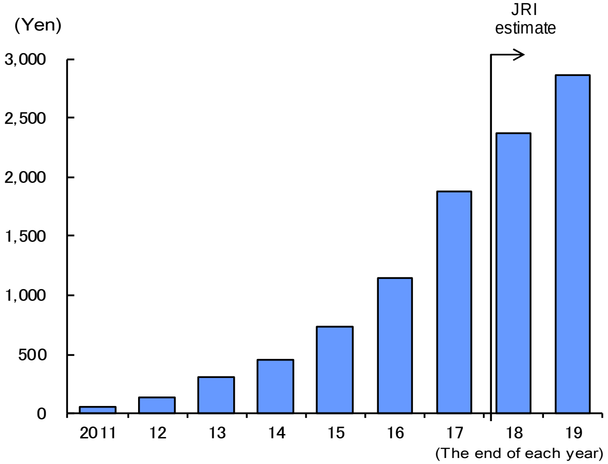
Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, QUICK.

Figure 7-2 JRI Estimate of the Effect of Purchasing of ETFs by BoJ on Nikkei Average



Source: The Japan Research Institute, Ltd. based on the data of Bloomberg L.P.

Figure 7-3 JRI Estimate of Accumulated Effect of Purchasing ETFs by BoJ on Nikkei Average (difference from actual)



Source: The Japan Research Institute, Ltd. based on the data of Bloomberg L.P.

Note: The estimate is based on the assumption that 1) the BoJ continues to buy ETFs at a pace of 6 trillion yen per year, 2) the Nikkei Average at the end of 2018 and 2019 will be 23,000 yen and 23,300 yen, respectively.

Prospects for Japan's economy - Projected real GDP change; 1.6% in FY2017 and 1.2% 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 October-December period 2017 grew by 0.5 per cent on an annualised quarter-on-quarter change basis (national accounts, the first preliminary estimates), a rise in 8 quarters running.

The main reason for the deceleration in growth from the previous quarter (2.2 per cent) was a considerable increase in imports (especially, a visible climb in a new type of smartphones). Meanwhile, domestic demand such as private consumption expenditure and business fixed investment stayed firm, in addition to an increase in exports at a relatively high pace. Accordingly, there is no alteration in the JRI view on current economic conditions that Japan's economic activity continues its recovery trend.

(2) Looking ahead, it is projected that the economic recovery will continue, led by the corporate sector. Exports will likely maintain their rising trend, against the background of solid economic growth of overseas economies and a worldwide improvement in willingness for business fixed investment.

Further, it is predicted that business fixed investment will be affected positively by factors such as 1) an increase in construction investment driven by redevelopment projects in metropolitan areas as well as by new building of accommodations and business logistics facilities, and 2) an improvement in willingness for investment in manufacturers encouraged by a rise in exports.

(3) In the household sector, a tone of corrections has been felt in the stock market since early February. Therefore, a further push to private consumption expenditure through the wealth effect cannot be relied on.

On the other hand, as a favourable aspect, income environments in the middle to lower income brackets have improved, reflecting factors such as a pause in the rise in the ratio of non-regular employees to the total and wage increases in medium and small-sized enterprises. Taking these elements into consideration, it is highly unlikely that private consumption expenditure will falter.

(4) As a result, it is projected that real GDP in FY2017 and FY 2018 will grow at a pace over Japan's potential output growth rate, which is currently estimated to be about 1.0 per cent, as demand at home and abroad stays solid. Namely, it is forecast that the annual real GDP growth rate will be 1.6 per cent in FY2017 and 1.2 per cent in FY2018.

(5) With respect to economic activity in FY2019, it is predicted that the pace of real GDP growth will decelerate, because private consumption expenditure will likely be pushed down in total by the lowering purchasing power due to the rise in the consumption tax rate from 8 to 10 per cent scheduled for October 2019.

However, it is unlikely that private consumption expenditure will wobble. This is because 1) the extent of the rise in the consumption tax rate in 2019 is less than that in April 2014 (from 5 to 8 per cent), 2) reduced tax rates are planned to be introduced, and 3) the degree of burden such as an increase in income tax and social insurance premiums is estimated to be less than that in 2014. As a result, real GDP will likely grow by almost 1 per cent in FY2019.

◆ The year-on-year change rate in the core CPI will likely stay at about 1 per cent

(6) 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 2017. A rise in energy prices and food prices has pushed up the total rate of year-on-year increase.

Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will stay at about 1 per cent, against the background of an improvement in supply-demand conditions on an aggregate basis, albeit with the pace of rise in energy prices slowing down.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of February 14, 2018)

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

	CY2017		CY2018				CY2019				CY2020	FY2016	FY2017	FY2018	FY2019
	7～9	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)		(Projection)
Real G D P	2.2	0.5	1.0	1.3	1.2	1.0	1.3	1.4	2.5	▲3.6	1.3	1.2	1.6	1.2	0.9
Private Consumption Expenditure	▲2.5	1.9	0.5	0.9	1.0	1.0	1.1	1.6	5.2	▲9.1	1.3	0.3	1.1	0.8	0.6
Housing Investment	▲5.9	▲10.2	▲7.2	▲3.2	0.8	3.2	6.4	1.9	▲3.1	▲9.8	▲7.2	6.2	▲0.1	▲2.9	▲0.2
Business Fixed Investment	3.9	2.8	2.0	2.4	2.7	2.7	2.6	2.4	2.4	2.3	2.3	1.2	3.3	2.6	2.5
Private Inventories (percentage points contribution)	(1.6)	(▲0.3)	(▲0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(▲0.1)	(▲0.5)	(0.3)	(0.3)	(▲0.3)	(▲0.0)	(0.1)	(▲0.1)
Government Consumption Expenditure	0.2	▲0.5	0.8	0.8	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.5	0.4	0.6	0.8
Public Investment	▲10.0	▲2.1	▲3.1	6.0	2.0	▲6.9	▲3.1	0.0	1.2	0.5	0.3	0.9	1.1	▲0.7	▲0.9
Net Exports (percentage points contribution)	(2.2)	(▲0.1)	(0.8)	(0.1)	(0.0)	(0.2)	(0.1)	(0.0)	(▲0.4)	(1.1)	(0.0)	(0.8)	(0.4)	(0.3)	(0.1)
Exports of Goods and Services	8.7	10.0	1.4	3.1	3.3	3.5	3.5	3.3	3.2	2.8	2.8	3.4	6.4	4.0	3.2
Imports of Goods and Services	▲4.8	12.0	▲3.0	2.8	3.2	2.7	3.0	3.2	5.4	▲3.3	2.9	▲1.0	3.9	2.4	2.6
(Ref.) Domestic Private Demand (percentage points contribution)	(0.6)	(0.8)	(0.3)	(0.9)	(1.0)	(1.1)	(1.2)	(1.2)	(2.7)	(▲4.7)	(1.1)	(0.3)	(1.1)	(0.8)	(0.7)
(Ref.) Public Demand (percentage points contribution)	(▲0.5)	(▲0.2)	(0.0)	(0.4)	(0.2)	(▲0.2)	(0.0)	(0.2)	(0.2)	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)

(% changes from the same quarter of the previous year) / (% changes from the previous fiscal year)

	7～9	10～12	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3	FY2016	FY2017	FY2018	FY2019
Nominal G D P	2.1	1.6	1.6	1.3	1.2	1.6	2.3	2.0	2.4	1.6	1.7	1.0	1.6	1.6	1.9
GDP deflator	0.2	0.0	0.1	▲0.1	0.2	0.5	1.0	0.7	0.8	1.3	1.3	▲0.2	0.0	0.4	1.0
Consumer Price Index (excluding fresh food)	0.6	0.9	0.8	0.9	0.9	0.8	0.7	0.7	0.9	2.0	2.1	▲0.2	0.7	0.8	1.5
(excluding fresh food, consumption tax)	0.6	0.9	0.8	0.9	0.9	0.8	0.7	0.7	0.9	1.1	1.1	▲0.2	0.7	0.8	1.0
Unemployment Rate (%)	2.8	2.8	2.7	2.7	2.7	2.6	2.6	2.6	2.6	2.6	2.6	3.0	2.8	2.7	2.6
Exchange Rates (JY/US$)	111	113	110	111	111	112	112	111	111	110	110	108	111	112	111
Import Price of Crude Oil (US$/barrel)	50	58	67	63	61	62	62	63	63	63	63	47	57	62	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.