

Monthly Report of Prospects for Japan's Economy

January 2019

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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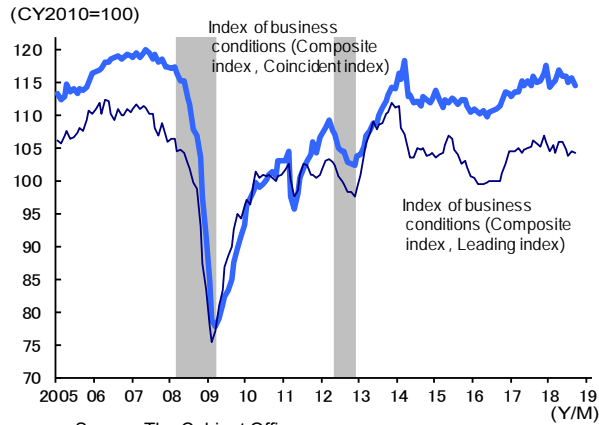
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The General Situation of Japan's Economy – The Economy Showed Signs of Recovery from Sluggishness

Figure 1-1 Economic Activity

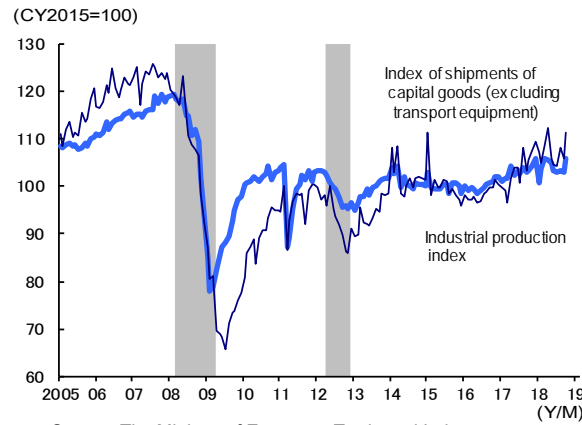
The CI coincident index declined for the first time in 2 months, reflecting a decrease in shipments of producer goods and durable consumer goods.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

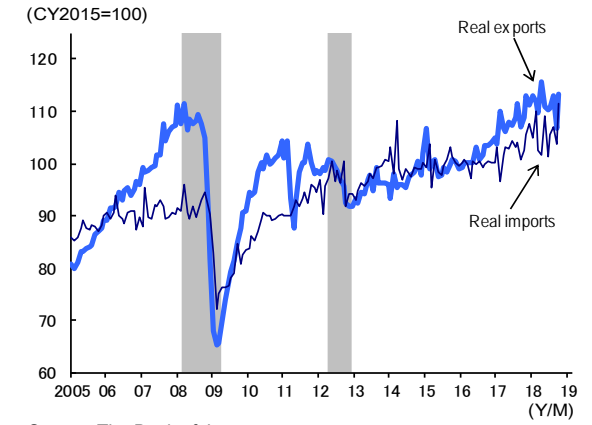
Industrial production surged thanks to the effect of recovery production following suspension of operations in factories due to a series of natural disasters.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

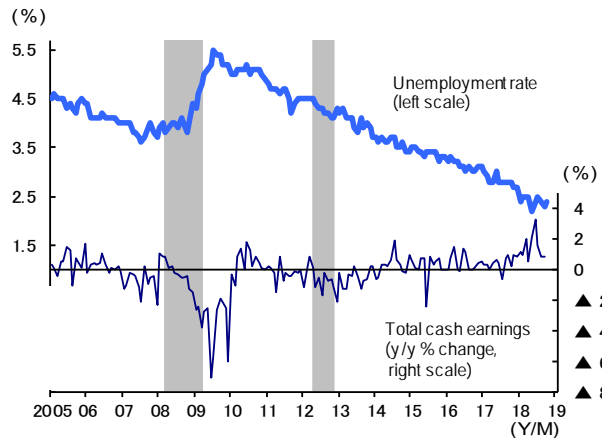
Real exports recovered from a plunge in the previous month. Real imports, especially those of motors and electronic parts, increased.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate was around the lowest level in 25 years. Nominal wages maintained a rising trend, albeit with some ups and downs.

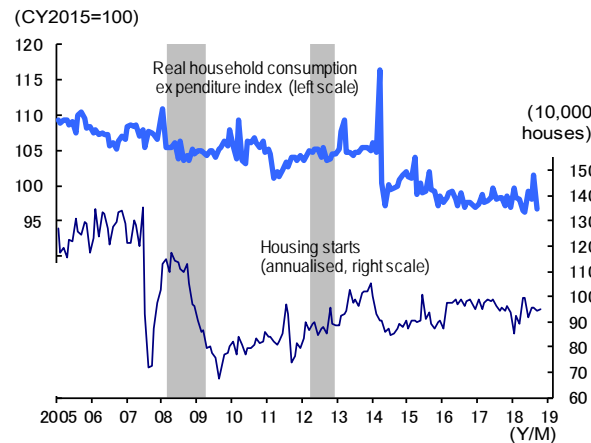


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

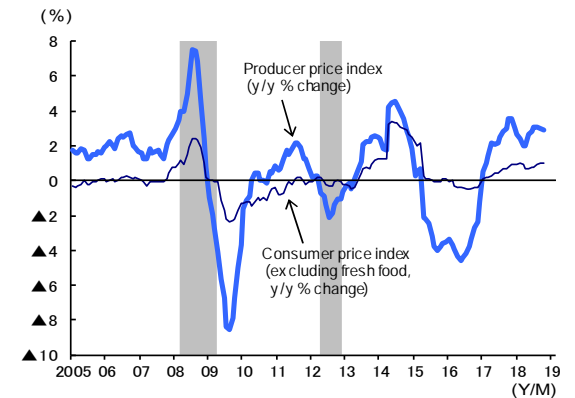
Real household consumption expenditure decreased against the backdrop of natural disasters. Housing starts increased both for owner-occupied houses and subdivision housing.



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

Figure 1-6 Prices

The rate of year-on-year increases in producer prices slowed down. Core consumer prices remained flat.



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

Monthly Report of Prospects for Japan's Economy January 2019
The Japan Research Institute, Limited

Signs of Recovery from a Temporary Decline Were Visible

◆ The Growth Rate for the July-September Period Turned Negative

Japan's real GDP in the July-September period decreased by 2.5 percent on an annualized quarter-on-quarter change basis (the second preliminary estimates), a negative figure for the second time in 2018. Against the backdrop of a series of natural disasters, exports of goods stalled due mainly to the suspension of plant operations and the temporary shutdown of a major airport. Consumer spending saw a decline, as consumers refrained from going out and consumer sentiment deteriorated. The reading of minus 1.2 percent in the first preliminary estimates was revised downward due to a considerable downswing in business fixed investment.

◆ Industrial Production Picked up

Despite the foregoing, signs of recovery were witnessed in October. The industrial production index for October significantly increased by 2.9 percent from the previous month. Production increased across a broad range of industries, especially that of general-purpose and business-use machinery, electronic parts and devices, thanks partly to recovery production following the suspension of plant operations due to

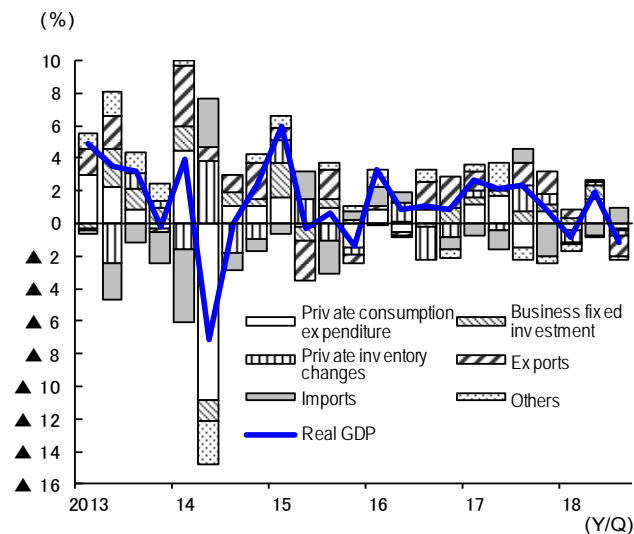
typhoons and earthquakes. Production is estimated to continue to pick up in the future, albeit with some ups and downs, as industrial production is anticipated to increase 0.6 percent month over month in November (negative 2.1 percent forecast by METI's flash estimates that reflect the correction of tendency errors in forecasts) and increase 2.2 percent month over month in December.

Exports also saw a recovery in October from the drop in the previous month. Exports increased to virtually all countries and regions, especially to the United States, although growth remained within a relatively narrow range.

◆ Signs of Rebound Were Also Seen in the Retail Sector

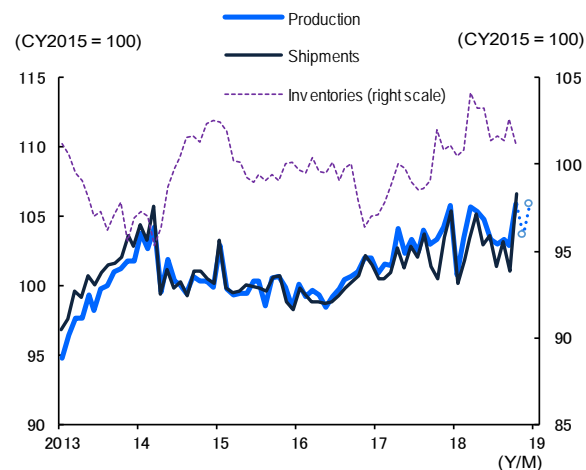
Sales of department stores in October turned positive, up 1.6 percent from the previous year. Sales increased for a broad range of items as sales of general goods and personal items were strong reflecting a pick-up of inbound demand and the renovation of some department stores and special events such as exhibitions of local products contributed to attracting more customers.

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



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

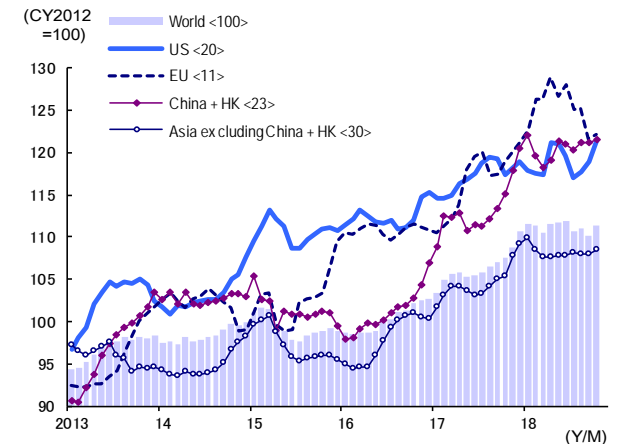
Figure 2-2 Industrial Production Index <seasonally adjusted>



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

Note: The latest two figures in the industrial production index are based on METI's flash estimates and 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 data of The Ministry of Finance, The Bank of Japan.

Note: Figures in the angled brackets show the shares in total nominal exports in FY2017.

Monthly Report of Prospects for Japan's Economy January 2019
The Japan Research Institute, Limited

Exports Have Picked up Moderately

◆ Inbound Demand Saw a Rebound

Inbound demand had significantly dropped since July due to the effects of natural disasters including heavy rainfall in Western Japan, typhoons and earthquakes. However, the number of overseas tourists visiting Japan turned upward in October.

As for the future look, inbound demand is likely to continue to increase in line with a recovery in the number of overseas tourists visiting Japan. We can point out the expansion of middle income earners in emerging Asian nations and the development of an environment more favorable to accept overseas tourists visiting Japan as positive contributing factors.

◆ Buoyant Exports of Goods Have Slowed Down

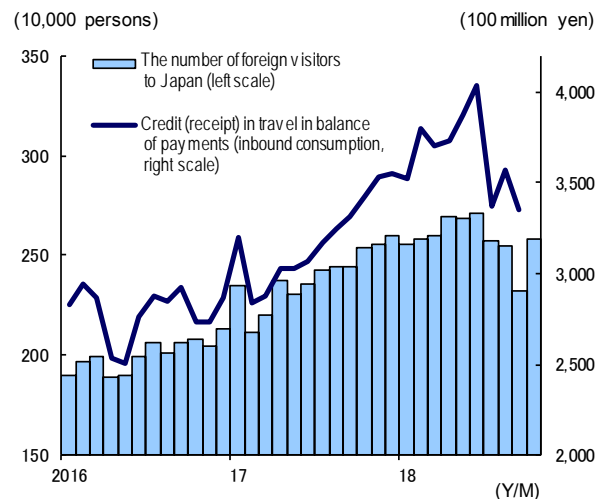
Japan's exports of goods have remained flat since the beginning of CY2018. This reflected a slowdown in buoyant exports of electronic parts and devices as the demand for smartphones saw a temporary drop as well as the suspension of plant operations and the temporary shutdown of a major airport due to a series of natural

disasters.

Looking at the future prospects, Japan's exports will likely return to a rising trend as the overseas economy continues to recover moderately. However, the pace of growth is expected to remain sluggish. The primary reason behind this is flagging exports to China. Against the backdrop of China's deleveraging policy and the uncertain outlook for the trade war between the United States and China, private-sector investment slowed rapidly. Consequently, exports of capital goods and semiconductors to China will likely decline going forward.

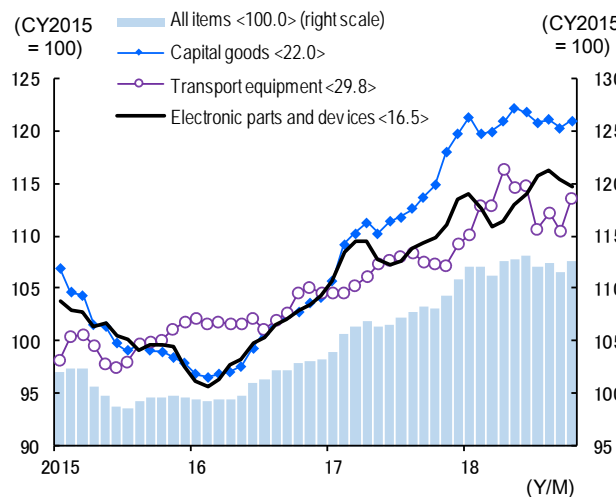
Meanwhile, trade friction with the United States will remain as a risk factor. The proposed hike in tariffs on automobiles has been put on hold for the time being due to the start of negotiations on the United States-Japan Trade Agreement on Goods (TAG). However any hike in automobile-related tariffs by the U.S. administration will have a significant impact on Japan's exports.

Figure 3-1 Receipt in Travel in Balance of Payments <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, Japan National Tourism Organization (JNTO).

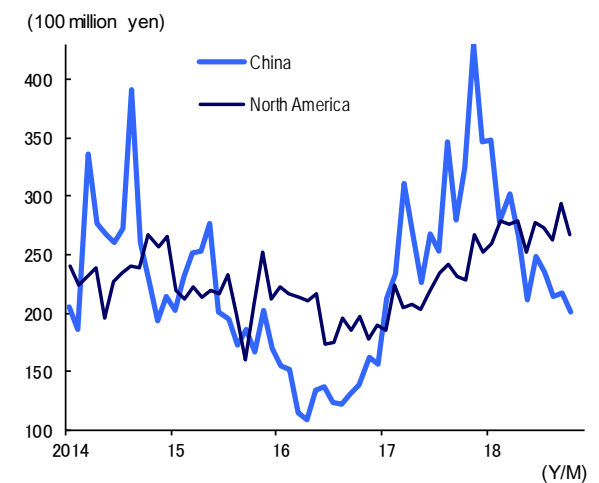
Figure 3-2 Real Exports by Item <seasonally adjusted, 3-month moving averages>



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

Note: Figures in the angled brackets show the shares in total nominal exports in FY2017.

Figure 3-3 Orders Received of Japan's Machine Tools by Destination <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of Japan Machine Tool Builders' Association.

Monthly Report of Prospects for Japan's Economy January 2019
The Japan Research Institute, Limited

With Profits Continuing to Be Firm, Business Fixed Investment Is on a Rising Trend

◆ Corporate Profits Continue to Be Firm

Corporate earnings have remained strong. According to Financial Statements Statistics of Corporations by Industry, Quarterly, while corporate sales value for the July-September period increased for the fourth consecutive quarter, current profits remained at a high level.

The primary contributing factor behind the increase in sales was a rise in sales prices. While corporations that faced hikes of raw material prices and personnel expenses passed them on to customers through higher sales prices, corporations on the buyer's side have accepted increases in goods and services prices to a certain extent amid the improved earnings environment.

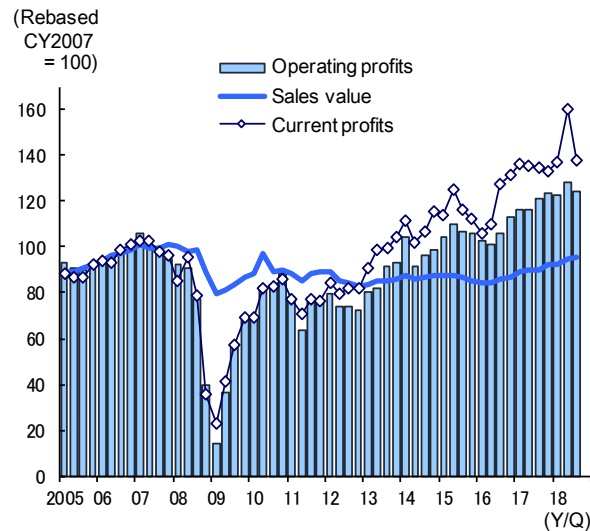
Looking at the future outlook, corporate earnings will continue to follow a mild recovery path. Corporate sales will likely remain on a recovery track amid resilient domestic demand including consumer spending and business fixed investment.

While a rise in personnel expenses will continue to put downward pressure on corporate earnings, variable costs are anticipated to decrease as crude oil prices peaked out in October. With the break-even point ratio in sales value remaining at the historical low level, a situation where an increase in sales can directly lead to the expansion of bottom line profits from core business operations is likely to continue.

◆ Business Fixed Investment Is on a Rising Trend

Reflecting abundant cash flow, capital investment has remained on an upward trend mainly in the fields of rationalization and labor saving against the backdrop of labor shortages. Furthermore, an expansion in forward-looking investment is expected in the future including commercialization of achievements of past research and development efforts.

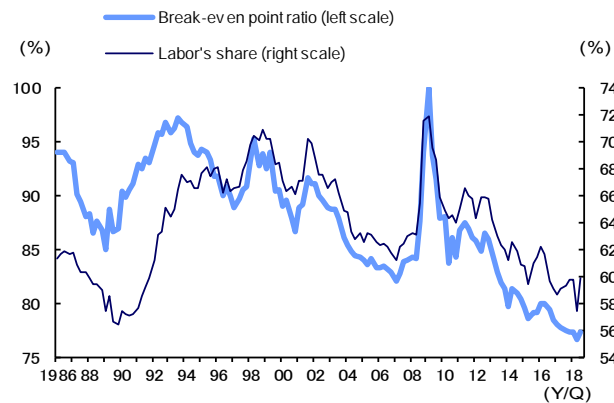
Figure 4-1 Sales Value and Profits of Japanese Enterprises <seasonally adjusted>



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

Note: All industries except for financial services and insurance.

Figure 4-2 Labor's Share and Break-even Point Ratio in Sales Value



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

Note: The break-even point ratio =

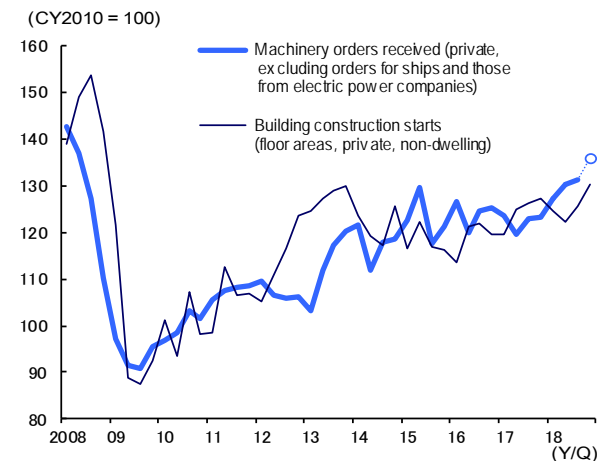
$$\frac{\text{break-even point sales value}}{\text{sales value}}$$

$$\text{Break-even point sales value} = \frac{\text{fixed costs}}{1 - (\text{variable costs} / \text{sales value})}$$

$$\text{Fixed costs} = \text{personnel expenses} + \text{depreciation expenses} + \text{interest payment}$$

$$\text{Variable costs} = \text{cost of goods sold} + \text{selling and administration expenses} - \text{personnel expenses} - \text{depreciation expenses}$$

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



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

Note: The latest figure in machinery orders is a forecast made by the Cabinet Office.

Monthly Report of Prospects for Japan's Economy January 2019
 The Japan Research Institute, Limited

Income Is Likely to Recover Steadily

◆ Employment and Income Conditions Continue to Improve

The employment situation continued to improve. The number of non-regular employees substantially jumped since the beginning of CY2018. This reflected the advancement of a shift from non-workforce to part-time workers mainly among women as a result of the development of daycare facilities among other factors.

Meanwhile, the rising trend for regular employees has also been maintained. The number of regular employees significantly jumped mainly in the manufacturing industry where the appetite for product development in new fields has been strong. The progress of work-style reform has also pushed forward the shift from part-time jobs to full-time jobs.

In addition, companies increasingly suffer from labor shortages across all industries, which have reached their severest level since the bubble economy. Against this backdrop, the pace of nominal wage growth also accelerated slightly. Scheduled

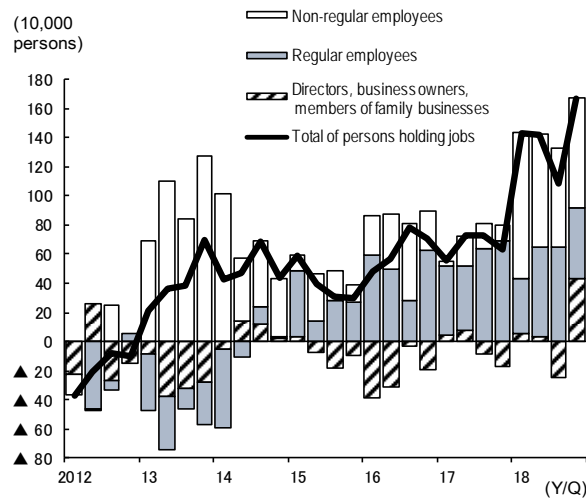
salaries for full-time workers have been rapidly increasing even after eliminating the effects of sample switchover. By industry, nominal wages rose substantially in industries which especially suffer from labor shortages including construction, wholesale and retail, transportation and postal services.

◆ Real Income Is Likely to Increase Firmly

As for the future outlook, labor demand and supply conditions are likely to remain tight from the perspectives of moderate economic recovery and continued population decline. As a result, both the employment situation and nominal wages are expected to continue to improve.

While an increasing trend for real compensation for employees will likely slow down slightly reflecting growing pressure for price increases, growth of around the 1 percent level is expected to be maintained on the back of the accelerated pace of wage growth.

Figure 5-1 Number of Persons Holding Jobs
<difference from a year earlier>

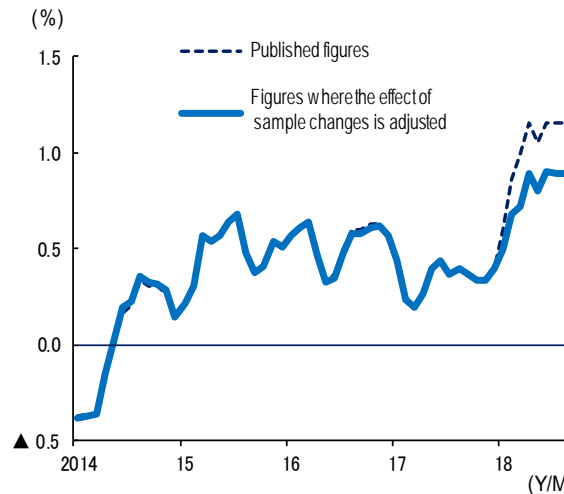


Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labor and Welfare.

Note: 1. Regular employees are persons employed for an indefinite period.

2. The figure in Q4 2018 is for October 2018.

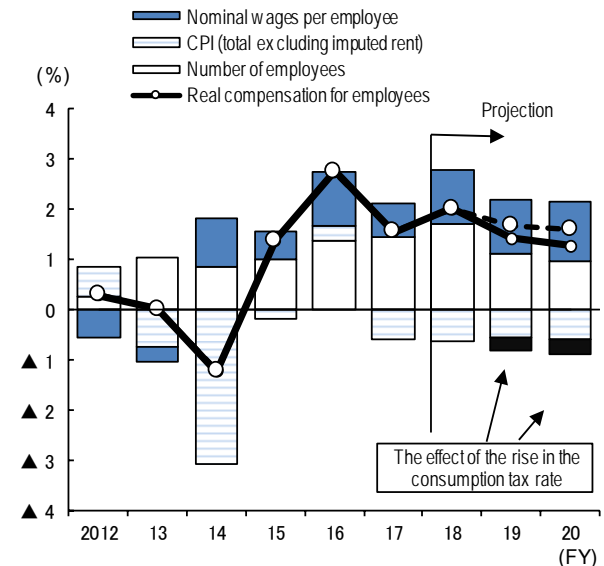
Figure 5-2 Scheduled Salaries for Full-time Workers
<year-on-year % change>



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

Note: 3-month moving averages.

Figure 5-3 Real Compensation for Employees
<year-on-year % change>



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

Monthly Report of Prospects for Japan's Economy January 2019
The Japan Research Institute, Limited

Private Consumption Expenditure Will Likely Pick up Moderately

◆ Private Consumption Is on a Recovery Trend

Consumer spending was pushed down in September as consumers refrained from going out due to natural disasters and the prices of fresh food and energy surged.

However, consumption of both goods and services has followed a mild recovery path since October on the back of robust employment and income conditions as negative factors dissipated. Department stores saw increases in sales of clothing as the temperature dropped. In food services, while there was temporary downward pressure on sales per customer due to promotional campaigns, an increased number of customers underpinned overall sales.

Meanwhile, consumer sentiment has been sluggish since the beginning of CY2018. This reflected the combined influences of lackluster stock prices, a series of natural disasters, hikes of fresh food and energy prices among other factors. Sluggish

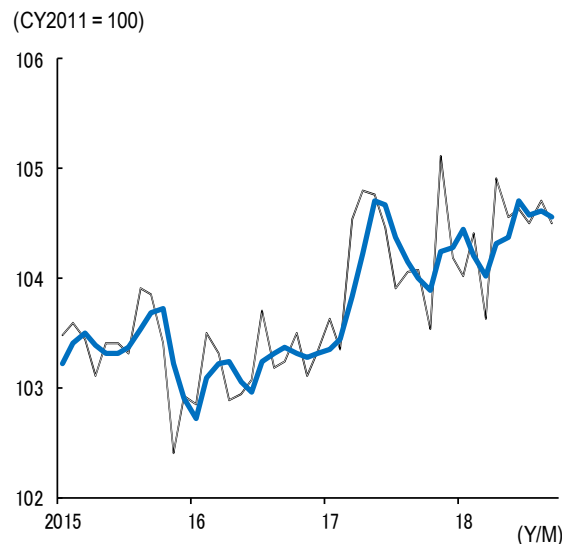
consumer sentiment has been one of factors behind slow recovery in private consumption despite income increases.

◆ Private Consumption Will Likely Follow a Moderate Recovery Path

As for the future outlook, private consumption is expected to follow a moderate recovery path as employment and income conditions continue to improve and consumer sentiment turns positive. Private consumption is anticipated to grow in proportion to income increases in the future as stock prices will likely follow a mild rising trend, fresh food prices will be stabilized, and energy prices will fall in line with a decrease in the price of crude oil.

However, since it is predicted to be a warm winter, private consumption may be pushed down if sales of seasonal products such as clothing are sluggish.

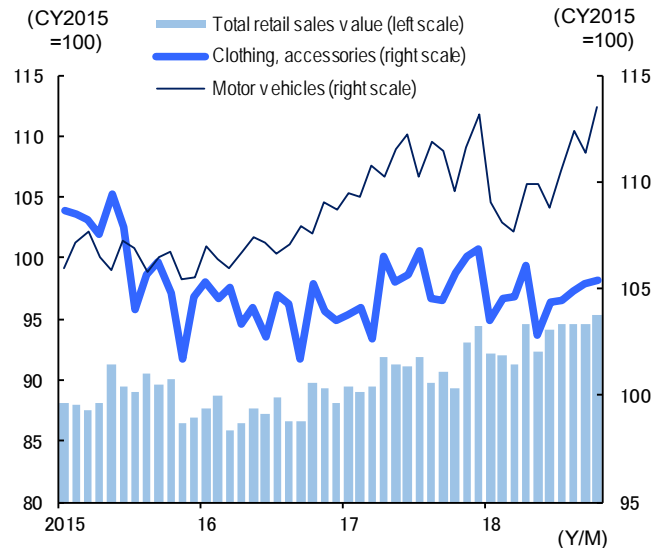
Figure 6-1 Synthetic Consumption Index
<seasonally adjusted>



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

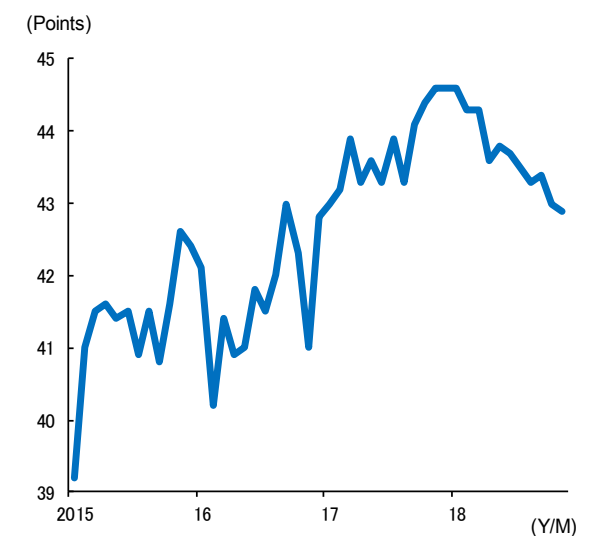
Note: The bold line shows 3-month moving averages.

Figure 6-2 Retail Sales Value
<seasonally adjusted>



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

Figure 6-3 Consumer Confidence Index
<seasonally adjusted>



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

Topics: Dual Income Households Demonstrate Particular Consumption Behaviors

◆ An Increase in Dual Income Households Has Driven up Private Consumption

The number of dual income households increased 1.35 million during the five years since 2012, reaching approximately 15 million in 2017. As consumption expenditures of dual income households tend to be higher than those of households with full-time housewives, the positive effect on private consumption is estimated to have been approximately 440 billion yen over the past five years.

◆ Dual Income Households Are Positive Toward Expenditures Related to Working, Saving Time and Improving Quality of Life

Consumption expenditures on the following items tend to be higher among dual income households than households with full-time housewives.

The first items are expenditures related to the work of the wife. Relevant expenditures include expenses for purchasing a car for commuting, daycare fees as well as expenses for female clothing such as business suits and entertainment expenses, particularly in the case of households with wives who work full time.

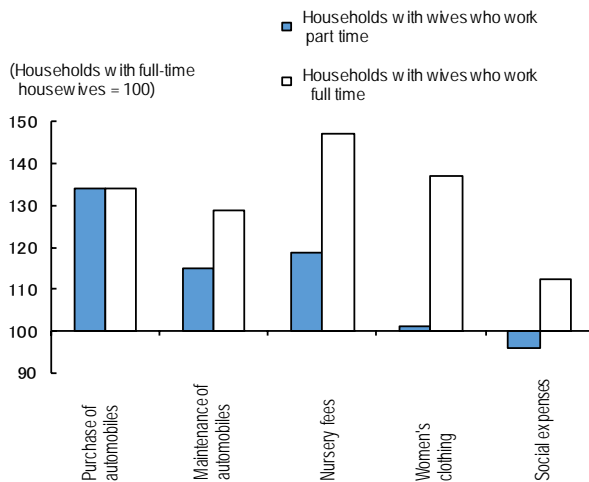
The second items are expenditures for saving time to make up for a decrease in

time that can be spent on housework. In order to shorten cooking time, the usage of prepared dishes and frozen food tends to increase. In households with wives who work full time, the purchase of bento boxes and the usage of food services are prominent. Furthermore, expenditures for time-saving household appliances and housework services also increase.

The third items are expenditures for improving the quality of life. Education related expenses tend to increase in particular. It seems that the additional income earned by a wife is often used for educational investment. Luxury expenditures such as travel expenses are also prominent among households with wives who work full time.

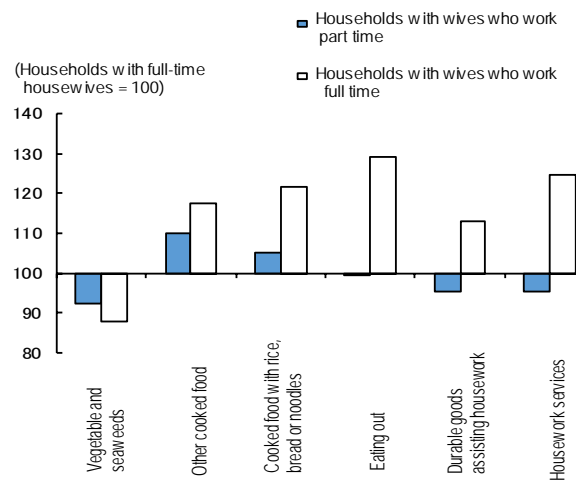
As for the future outlook, as the number of dual income households will likely continue to increase at least for the next several years, positive effects on consumption are anticipated to be maintained. Furthermore, as labor demand and supply conditions are likely to remain tight, the shift from part-time jobs to full-time jobs among female workers is expected to continue. It is predicted that the increased household income of dual income households will continue to boost consumption for the foreseeable future.

Figure 7-1 Expenditures Related to the Work of the Wife



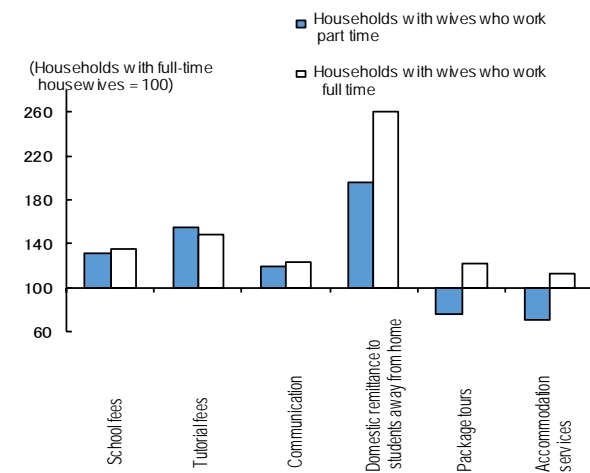
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

Figure 7-2 Expenditures for Saving Time



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

Figure 7-3 Expenditures for Improving the Quality of Life



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

Prospects for Japan's Economy - Projected Real GDP Change; 1.0% in FY2019 and 0.9% in FY2020

◆ Japan's Economic Activity Will Likely Turn to a Recovery Path, Driven by Firm Domestic Demand

(1) Japan's real GDP in the July-September period in 2018 decreased by 2.5 percent on an annualized quarter-on-quarter change basis (national accounts, the second preliminary estimates), a negative figure for the first time in two quarters. The initial reading of minus 1.2 percent in the first preliminary estimates was revised downward mainly due to a considerable downswing in business fixed investment. Factors such as a reaction from the higher increase rate in the previous quarter and supply constraints caused by a series of natural disasters seem to have weighed on capital investment. However, we judge that the attitude of enterprises to business fixed investment did not necessarily turn cautious, as machinery orders, a leading indicator for capital investment, were forecast to increase in the October-December period, posting a sixth successive quarterly rise.

(2) Looking ahead, it is predicted that the real GDP growth rate in the October-December quarter will turn positive to a relatively high figure, boosted by recovery production from the fall caused by a series of natural disasters. Also economic activity thereafter will likely continue its recovery trend, driven by domestic demand.

While uncertainties surrounding overseas economies such as intensified trade friction between the United States and China and a slowdown of the Chinese economy will likely increase, the investment appetite of the corporate sector will remain robust reflecting corporate earnings at a high level, a severe shortage of workers, superannuated plants and equipment, etc. Thus, it is projected that business fixed investment will continue its increasing trend mainly in the fields of rationalization and labor saving as well as research and development investment, which are less susceptible to overseas demand conditions. Private consumption expenditure will also likely follow a moderate rising path, bolstered by good income environments.

(3) Further, it is projected that economic activity during FY2019 and FY2020 will have a larger extent of swings on a quarterly real GDP growth rate basis due to factors such as the rise in the consumption tax rate and the Tokyo Olympic and

Paralympic Games. However, the actual burden on households is predicted to be minimized as the hike of the tax rate will be smaller than that in 2014 and measures such as the reduced tax rate and free education and childcare for infancy are expected to be introduced. Consequently, a significant decline in private consumption will likely be avoided. In addition, weakening demand for construction after the Olympic Games will likely have only a slight impact on economic activity.

(4) As a result, while the real GDP growth rate in FY2018 will likely remain 0.7 percent, less than the estimated potential growth rate of Japan's economy, affected by a series of natural disasters, GDP growth of around 1 percent is expected to be maintained both in FY2019 and in FY2020. As the self-sustained recovery mechanism led by domestic demand has become more resilient, it is predicted that robust growth will be able to be maintained despite downward pressure from the consumption tax hike on the growth rate.

◆ The Year-on-year Change Rate in the Core CPI Will Likely Continue to Be around 1 Percent

(5) The core CPI, which excludes fresh food, remained flat. While the pace of increase in energy prices widened, those of other items narrowed. Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will be around 1 percent. This is because, while the upward pressure will likely strengthen from the supply-demand perspective due to improvement in employment and income conditions, the pace of the rise in energy prices will likely gradually slow down.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of December 10, 2018)

	(seasonally adjusted, annualised % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2018		CY2019				CY2020				CY2021	FY2018	FY2019	FY2020
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)	(Projection)
	(Actual)	(Projection)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	▲ 2.5	2.5	2.0	1.5	2.3	▲ 3.8	2.2	1.6	2.1	▲ 0.5	1.1	0.7	1.0	0.9
Private Consumption Expenditure	▲ 0.7	2.1	1.3	1.6	4.3	▲ 8.5	3.7	1.8	2.2	▲ 0.5	1.0	0.7	0.7	0.7
Housing Investment	2.7	3.0	6.7	0.0	▲ 1.0	▲ 4.5	▲ 4.1	1.0	1.5	1.8	2.0	▲ 4.3	0.7	▲ 0.5
Business Fixed Investment	▲ 10.6	4.8	3.2	2.9	4.7	▲ 1.8	2.1	2.7	2.4	2.2	2.2	2.7	2.0	2.0
Private Inventories (percentage points contribution)	(0.1)	(0.0)	(0.0)	(▲ 0.0)	(▲ 0.5)	(0.3)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(▲ 0.0)	(0.0)
Government Consumption Expenditure	0.9	1.2	1.0	0.6	0.6	0.6	0.6	0.7	1.6	▲ 0.3	0.7	0.8	0.8	0.7
Public Investment	▲ 7.7	2.7	7.1	1.3	▲ 2.7	▲ 0.8	0.3	0.0	▲ 2.0	▲ 1.2	▲ 0.8	▲ 2.3	0.8	▲ 0.8
Net Exports (percentage points contribution)	(▲ 0.3)	(0.2)	(0.1)	(0.0)	(▲ 0.4)	(1.1)	(▲ 0.3)	(0.0)	(0.2)	(▲ 0.5)	(0.1)	(▲ 0.0)	(0.1)	(0.1)
Exports of Goods and Services	▲ 6.9	4.9	2.7	2.4	2.4	2.2	2.0	2.0	3.1	▲ 0.6	2.2	1.8	2.1	1.9
Imports of Goods and Services	▲ 5.5	3.6	2.2	2.4	4.4	▲ 4.0	3.6	2.0	2.0	2.0	1.8	2.0	1.6	1.7
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 2.0)	(2.0)	(1.4)	(1.3)	(2.6)	(▲ 4.8)	(2.3)	(1.5)	(1.7)	(0.1)	(1.0)	(0.8)	(0.7)	(0.7)
(Ref.) Public Demand (percentage points contribution)	(▲ 0.2)	(0.4)	(0.5)	(0.2)	(▲ 0.0)	(0.1)	(0.1)	(0.1)	(0.2)	(▲ 0.1)	(0.1)	(0.0)	(0.2)	(0.1)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
Nominal GDP	▲ 0.3	0.3	1.7	1.6	3.0	1.7	1.8	1.9	1.8	2.1	1.9	0.8	2.0	1.9
GDP deflator	▲ 0.3	▲ 0.0	0.6	0.6	0.9	1.2	1.2	1.3	1.4	0.8	0.8	0.1	1.0	1.1
Consumer Price Index (excluding fresh food)	0.9	1.1	1.1	1.1	1.0	2.0	2.0	1.9	1.9	1.0	1.0	1.0	1.5	1.4
(excluding fresh food, consumption tax)	0.9	1.1	1.1	1.1	1.0	1.0	1.0	0.9	0.9	1.0	1.0	1.0	1.0	0.9
Unemployment Rate (%)	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.1	2.1	2.1	2.4	2.2	2.1
Exchange Rates (JY/US\$)	111	113	114	113	111	110	109	109	108	108	107	112	111	108
Import Price of Crude Oil (US\$/barrel)	76	78	69	73	73	73	73	73	73	73	73	73	73	73

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.