

# Monthly Report of Prospects for Japan's Economy

March 2019

Macro Economic Research Center  
Economics Department



The Japan Research Institute, Limited

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

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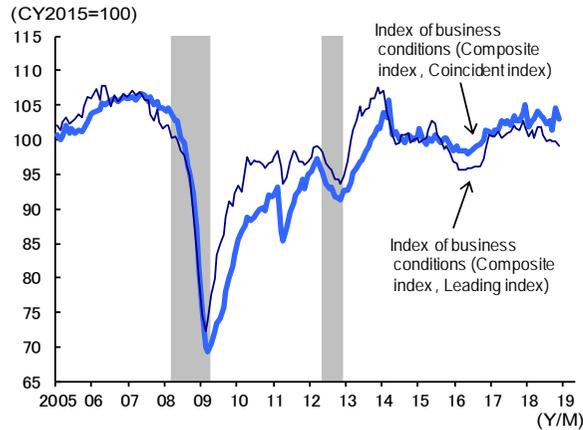
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# The General Situation of Japan's Economy – The Economy Is Somewhat at a Standstill

**Figure 1-1 Economic Activity**

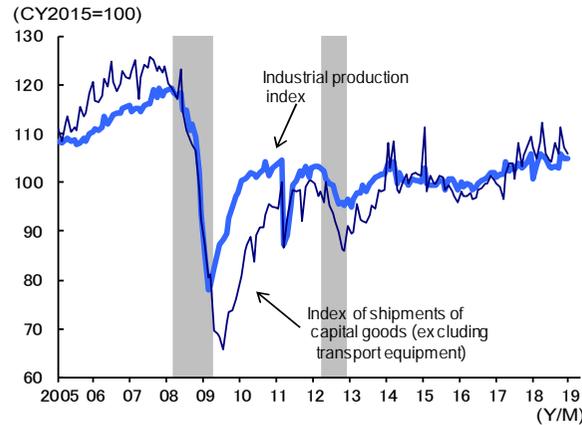
The CI coincident index dropped, due mainly to lower industrial production and shipments.



Source: The Cabinet Office.

**Figure 1-2 The Corporate Sector**

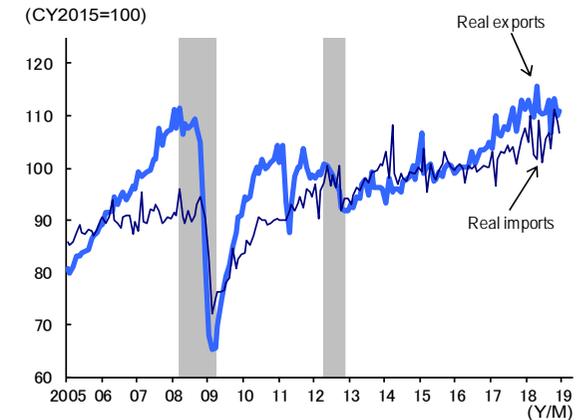
Industrial production is seesawing due to stagnation in foreign demand.



Source: The Ministry of Economy, Trade and Industry.

**Figure 1-3 Overseas Demand**

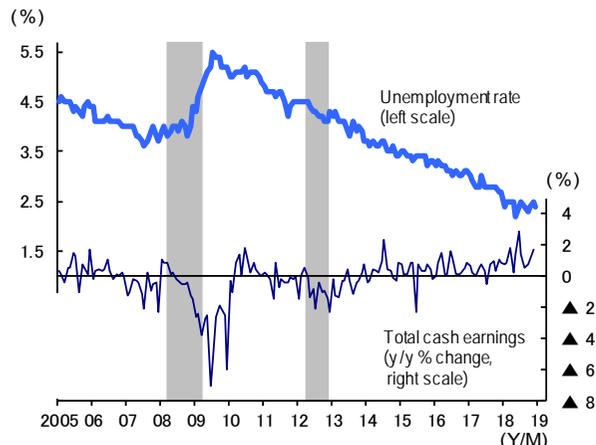
Exports to China were weak. Imports continue in an uptrend.



Source: The Bank of Japan.

**Figure 1-4 Employment and Income**

The unemployment rate is hovering near a 25-year low. The pace of rise in nominal wages has accelerated.

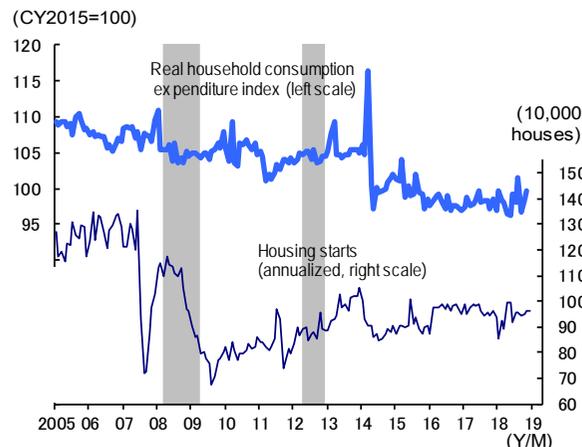


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

\* The shaded area indicates the recession phase.

**Figure 1-5 The Household Sector**

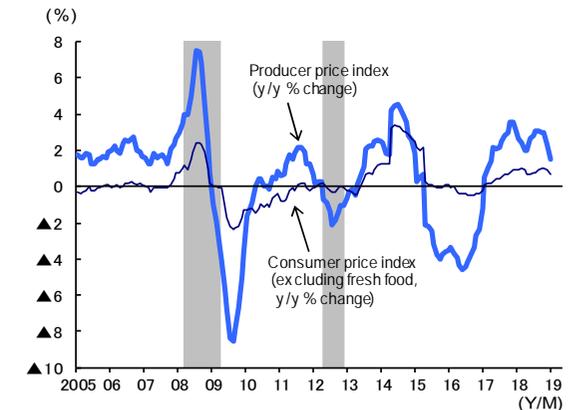
Real household consumption has picked up. Housing starts increased for owner-occupied houses and subdivision housing.



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 and consumer prices has slowed against a backdrop of lower crude oil prices.



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 March 2019  
The Japan Research Institute, Limited

# Domestic Demand Is Firm, While Overseas Demand Is Sluggish

## ◆ Corporate Activity Remains Solid

The all industry activity index for November dropped slightly by 0.3% month-on-month, but nevertheless maintained almost the same level as in October, which saw a sharp rise due to post-disaster recovery production. Domestic demand continues to rebound, supported by expanded activity in the service sector.

However, manufacturing activity appears to have stalled. The industrial production index for December was down 0.1% from the previous month, marking the second consecutive month of lower production. Production of semiconductor manufacturing equipment and electronic components/devices has turned downward in the wake of declining exports to China. The outlook for January is -0.1% (METI's estimate, after correcting for a bias error in the forecasting index, is -2.3%) while that for February is +2.6%, following a back-and-forth pattern.

Exports were sluggish in December. Despite an increase in the number of vehicles

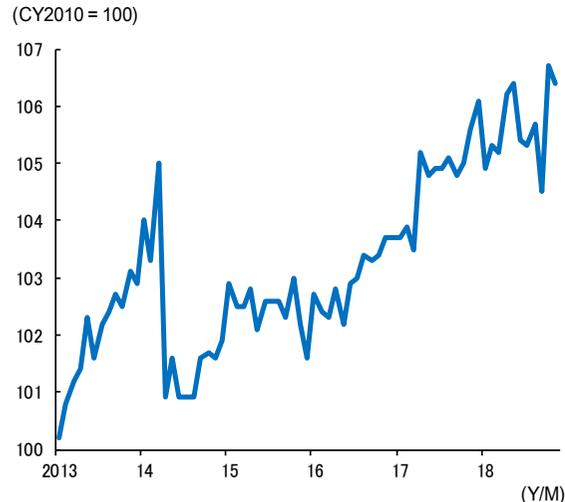
and other goods exported to the US and Europe, there was a decrease in capital goods and electronic components/devices exported to China.

## ◆ The Household Sector Is Making a Mild Recovery

Employment and income conditions continued to improve. The unemployment rate is hovering near a 25-year low, indicating that labor supply demand conditions remain tight. Total cash earnings for November (derived from a sampling survey statistically processed to replicate a complete survey) were up 1.7% year-on-year, showing continued expansion.

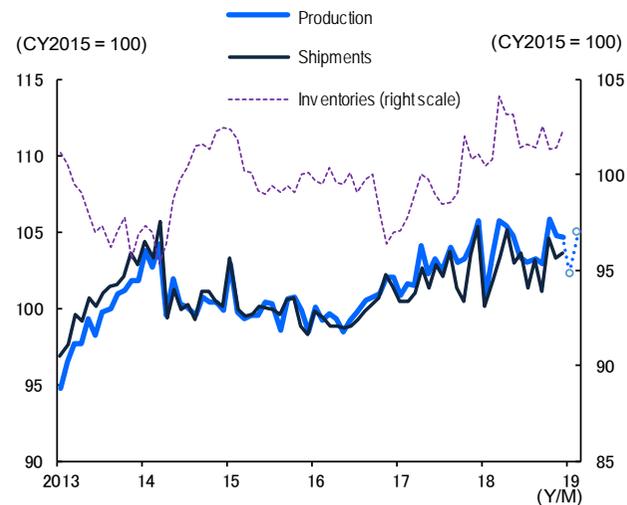
Private consumption is gradually recovering. Although consumer sentiment is weak against a backdrop of falling share prices, positive employment and income conditions are providing support. The Synthetic Consumption Index for November dropped by 0.4% month-on-month, but on the whole the index remains in an uptrend.

Figure 2-1 All Industry Activity Index  
<seasonally adjusted>



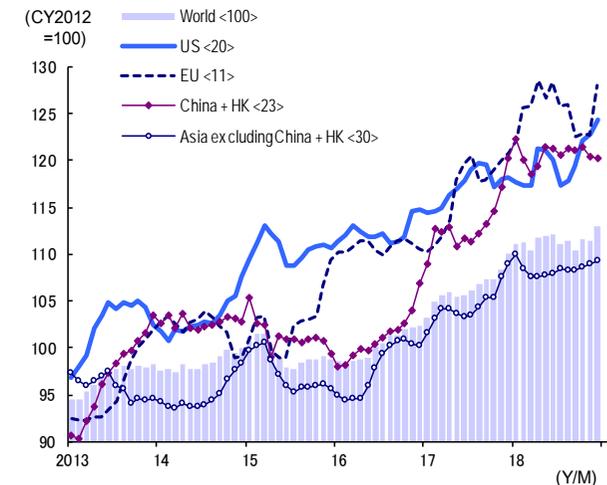
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.

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 forecasts for January and February based on METI's estimate and the production forecast index, respectively.

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 March 2019  
The Japan Research Institute, Limited

# Exports Are Sluggish

## ◆ Demand Related to Inbound Tourism Is Rebounding

Demand related to inbound tourism is bouncing back from the downward pressure caused by natural disasters. Both the number of tourists and the amount of consumption have returned for the most part to their pre-slump levels.

In terms of future outlook, demand related to inbound tourism is expected to continue growing, propelled by an expanding middle class in emerging Asian countries and better infrastructure for receiving tourists in Japan.

## ◆ Exports of Goods Have Slowed Down

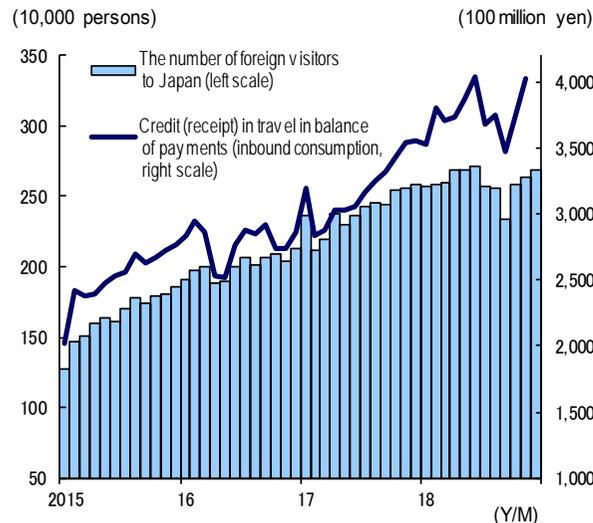
Although exports of goods recovered in December from the preceding month's decline, the sluggish trend from last year remains intact. A pause in global smartphone demand resulted in weakness in electronic component/device exports.

Exports of capital goods to China also declined due to a sudden slowdown in Chinese private-sector investment in the latter half of last year.

Looking at future prospects, growth is likely to remain sluggish because of stagnant exports to China, despite robust exports to developed countries continuing to enjoy economic stability.

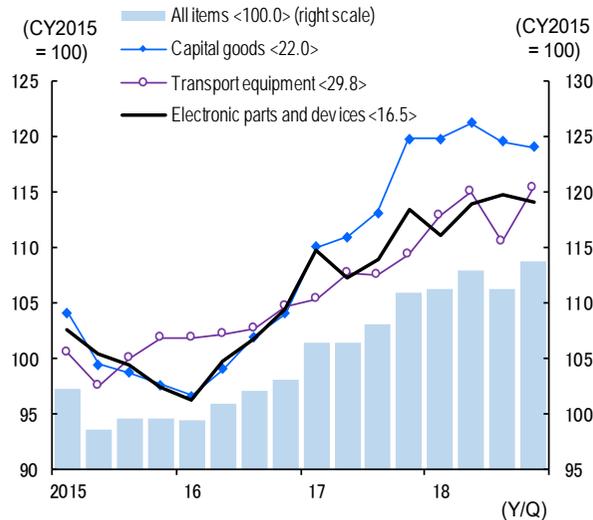
Possible intensification of Japan-US trade frictions poses the risk of greater downward pressure on exports. While the start of Japan-US talks on a Trade Agreement on Goods (TAG) have deferred higher automobile tariffs for the time being, any quantitative restrictions on automobile exports or foreign exchange provisions incorporated into this agreement could have a significant impact on Japan's exports.

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



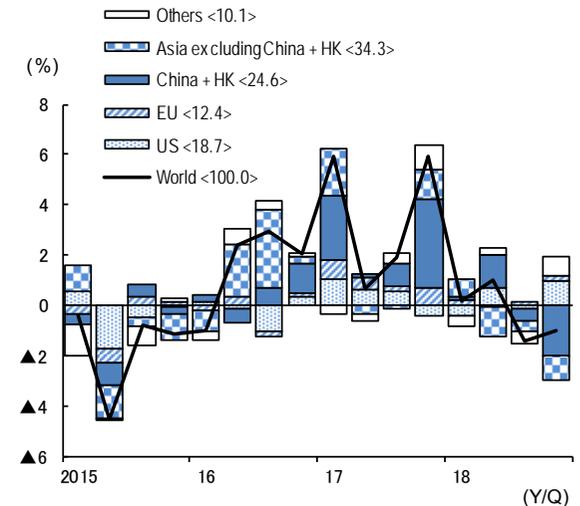
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, Japan National Tourism Organization (JNTO).

Figure 3-2 Real Exports by Item <seasonally adjusted>



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 Real Exports of Capital Goods by Destination <seasonally adjusted, q/q>



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 of capital goods in FY2017.

# Robust Corporate Profits Have Kept Business Fixed Investment on the Rise

## ◆ Corporate Profits Continue to Be Firm

Corporate earnings continue to be firm. According to the Financial Statements Statistics of Corporations by Industry quarterly report, current profits for the period July-September were high, albeit down from the substantial rebound seen in the previous term.

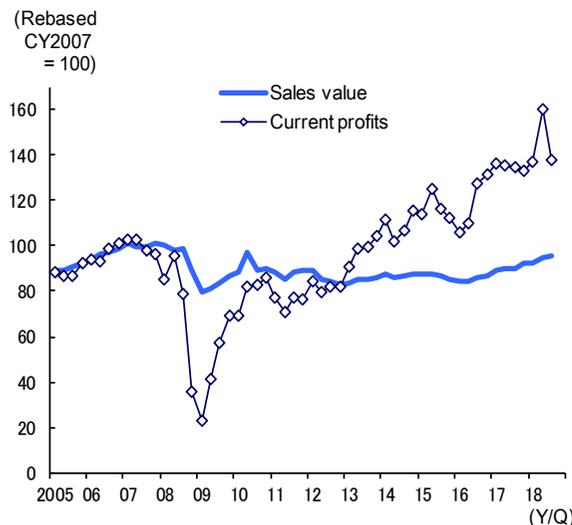
Expectations are that corporate earnings will continue on their mild recovery path. With the breakeven point ratio remaining at a historically low level, reduced variable costs attributable to the drop in crude oil prices since October of last year and increased sales from a rebound in private consumption and capital investment will likely help boost earnings.

## ◆ Business Fixed Investment Is on a Rising Trend

Capital investment has remained on an upward trend. The total supply of capital goods, a coincident index for capital investment, has ended its temporary downturn and is now moving upward. With abundant cash flow available, investment in rationalization and labor-saving efforts to address labor shortages as well as investment in maintenance/upgrades to combat obsolescence will be the driving forces.

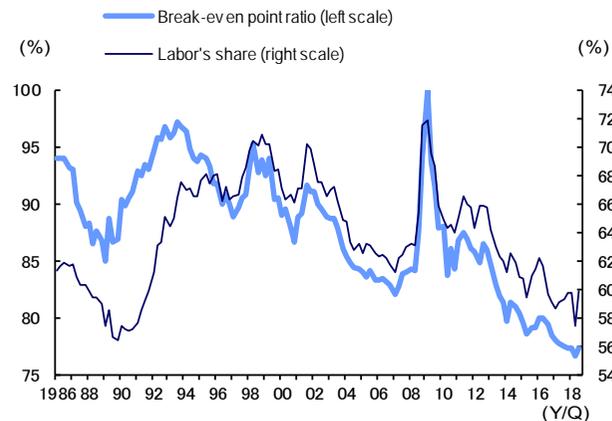
The future outlook is for a gentle but steady increase. Although a slowing Chinese economy and other uncertainties about overseas demand will offer overhead resistance to this trend, the strong need for rationalization and labor-saving investment make it very unlikely that capital investment will slump in the absence of an unexpected economic decline globally.

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



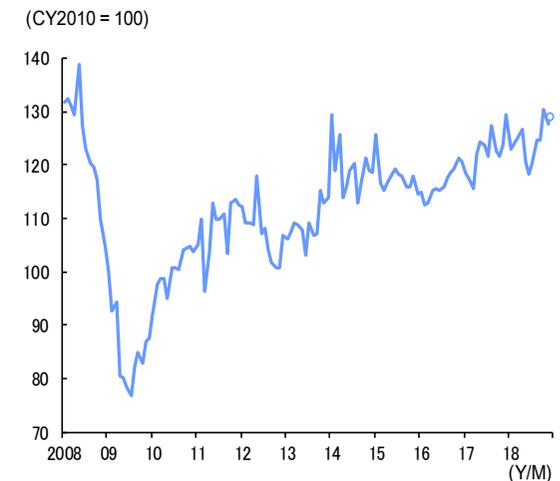
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: The break-even point ratio =  

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

$$\text{Break-even point sales value} = \frac{\text{fixed costs}}{1 - (\text{variable costs} / \text{sales value})}$$
 Fixed costs = personnel expenses + depreciation expenses + interest payment  
 Variable costs = cost of goods sold + selling and administration expenses - personnel expenses - depreciation expenses

Figure 4-3 Index of Total Supply of Capital Goods <excluding transport equipment>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.  
Note: The latest figure is based on the index of shipments of capital goods excluding transport equipment.

# Income Is Recovering Steadily

## ◆ Employment and Income Conditions Continue to Improve

The employment situation continues to improve, with the number of people in non-regular employment – especially senior citizens, young adults, and women of child-rearing age – rising significantly since the start of 2018.

Meanwhile, the rising trend in the number of regular employees remains intact. There has been a notable increase in the number of employees in the manufacturing industry, where there has been booming product development in new fields. The progress of work-style reform has also given momentum to the shift from part-time jobs to full-time jobs.

In addition, labor shortages have helped slightly accelerate the pace of nominal wage growth. Even after eliminating the effects of sample switchover, the pace of rise in scheduled salaries for full-time workers has been accelerating.

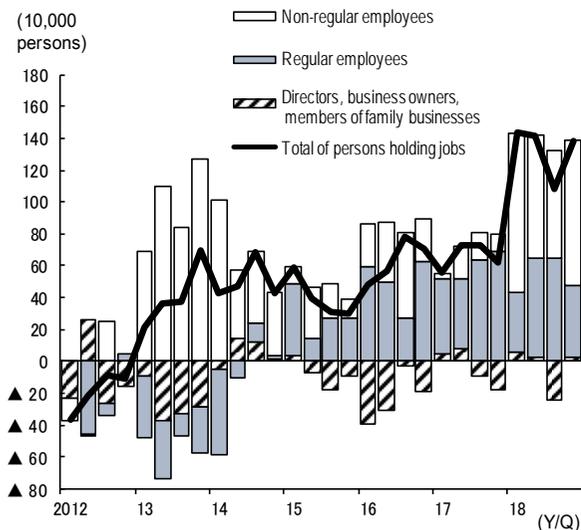
## ◆ Real Income Is Likely to Increase Firmly

A look at future prospects shows a high likelihood that both the moderate economic recovery and continued population decline will keep labor supply demand conditions tight. As a result, both employment conditions and nominal wages are expected to continue improving.

The pace of improvements to employment conditions is expected to be steady and moderate. New openings, a leading indicator, have slowed since the start of 2018, and are expected to plateau over the short term.

The pace at which real compensation for employees has been improving is expected to ease somewhat from FY2019 onward due primarily to a slowdown in the increase of the number of employees. Nevertheless, rising nominal wages should provide the underpinning needed to keep growth at around the 1% level.

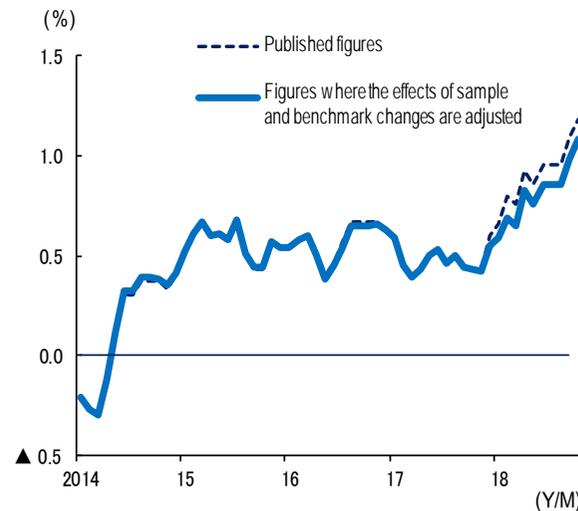
Figure 5-1 Number of Persons Holding Jobs  
<difference from a year earlier>



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

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

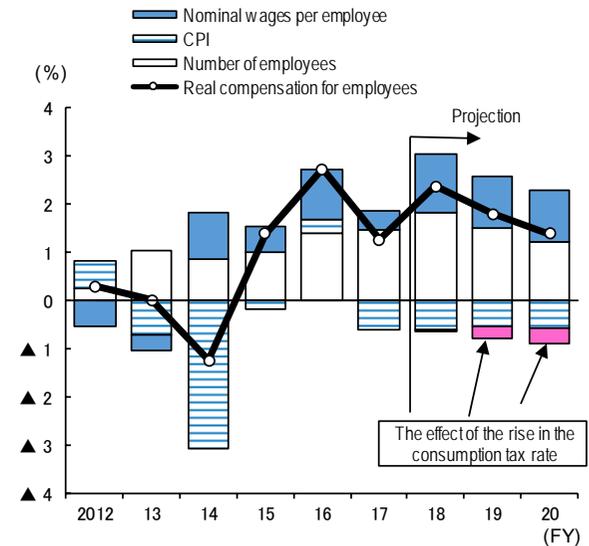
Figure 5-2 Scheduled Salaries for Full-time Workers  
<year-on-year % change>



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 March 2019  
The Japan Research Institute, Limited

# Private Consumption Expenditure Is Increasing Moderately

## ◆ Private Consumption Is Increasing Moderately

Although highly susceptible to weather factors, private consumption on the whole made a modest recovery as employment and income conditions improved.

Warm winter temperatures led to somewhat of a decline in November, as sales of food products for hot pot dishes as well as coats and other winter goods slumped.

However, December saw a rebound. Temperatures dropped in the latter half of the month and sales of apparel goods recovered, while the food service business also saw increased sales of Christmas chicken and other seasonal goods.

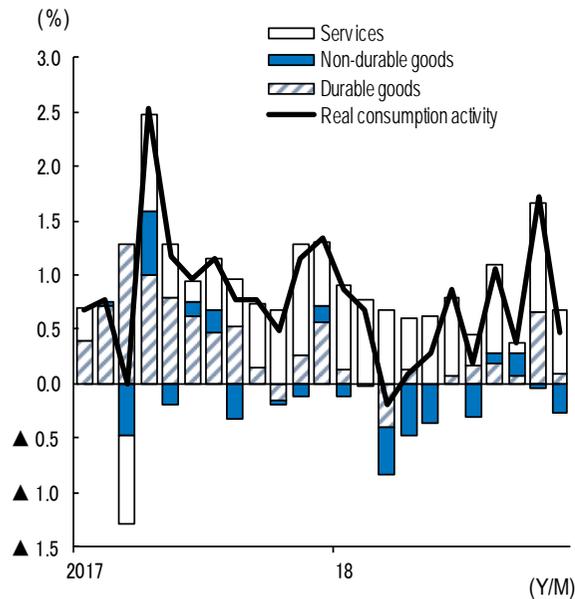
The future outlook is that private consumption will maintain its steady recovery as employment and income conditions continue to improve. The negative wealth effect due to the fall in share prices since last autumn has thus far been limited.

## ◆ Housing Investment Is Expected to Increase Slightly

Housing starts for December were up 0.6% month-on-month, the third consecutive up month. While concerns over excess supply keep rental housing in a downtrend, starts of subdivision housing and owner-occupied houses have been moving upward since the beginning of last autumn, assisted by improving employment and income conditions and by last-minute demand before the consumption tax rate hike.

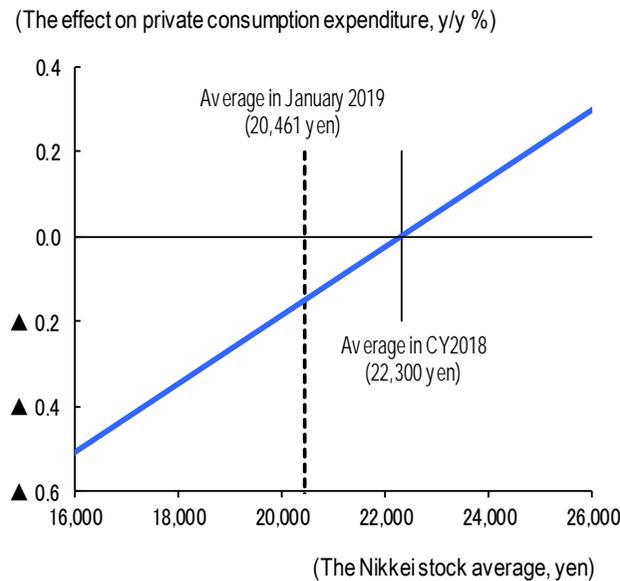
The future should see the increases continue until around April, six months prior to the tax rate hike. As measured by a housing sentiment indicator (custom-built detached houses), orders should continue to rise, albeit only slightly, through the end of March while the pre-hike tax rate remains applicable.

Figure 6-1 BoJ's Consumption Activity Index <year-on-year % change>



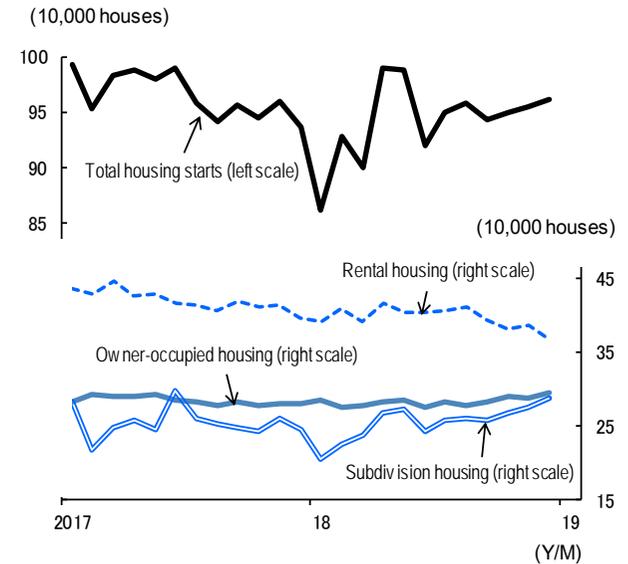
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 6-2 Stock Prices in 2019 and the Negative Wealth Effect



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office, Nikkei.  
Note: Estimates by JRI.

Figure 6-3 Housing Starts by Type <annualized, seasonally adjusted>



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

# Topic: Improved Productivity Is Essential for Coping with Labor Shortages

## ◆ Labor Productivity Is Stagnating

As Japan's population continues to decline, labor supply should sooner or later peak. To avoid supply constraints and continue economic growth, improving productivity will be essential. However, Japan's labor productivity has stagnated, especially in nonmanufacturing industries. Without continual improvements to productivity, it is quite possible that the growth rate will fall to the neighborhood of 0% in the latter half of the 2020s.

Factors underlying this slump in productivity in nonmanufacturing industries include (1) a stagnant capital equipment ratio and (2) lagging adoption of cutting-edge information technology. On a nominal basis, (3) price setting not sufficiently reflective of service quality constitutes another issue.

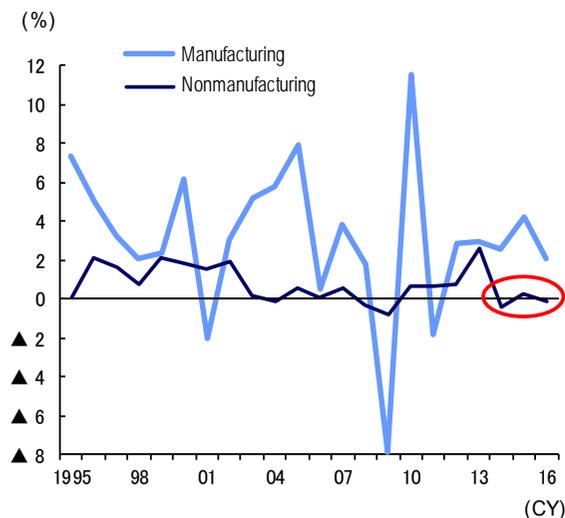
The capital equipment ratio for nonmanufacturing industries has leveled off since the 2000s, and the ratios for the food/beverage, accommodation, and other service

industries have been dropping in recent years. One reason for this is the difficulty faced by the many small companies in these service industries in introducing efficient facilities, IT equipment and software. Prices in Japan tend to be set relatively low vis-à-vis service quality, and analysis shows that the productivity gap with the US would shrink if differences in service quality were reflected in prices.

## ◆ Productivity Should Be Improved through Inter-company Collaboration

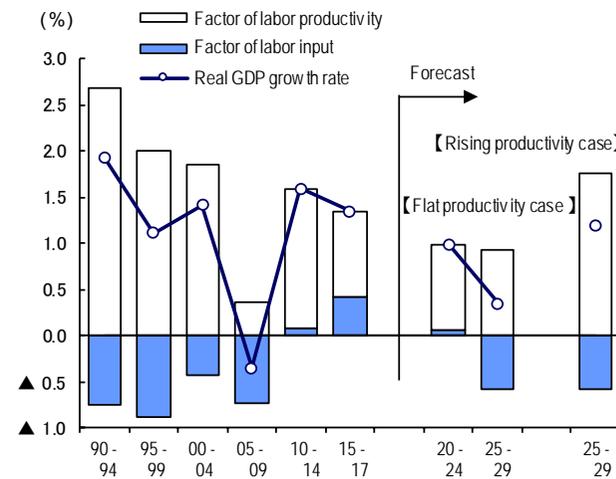
Improving productivity at small and medium-sized companies will require greater investment capacity achieved by cutting costs through joint procurement as well as greater ability to negotiate prices. Collaboration that transcends differences in scale, industry sector, and locale will also be important, so large corporations should be urged to share their management know-how with small and medium-sized enterprises, and companies in different industry sectors encouraged to collaborate through open innovation.

Figure 7-1 Labor Productivity by Type  
<year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.  
Note: Labor productivity = real GDP / (the number of workers × hours worked)

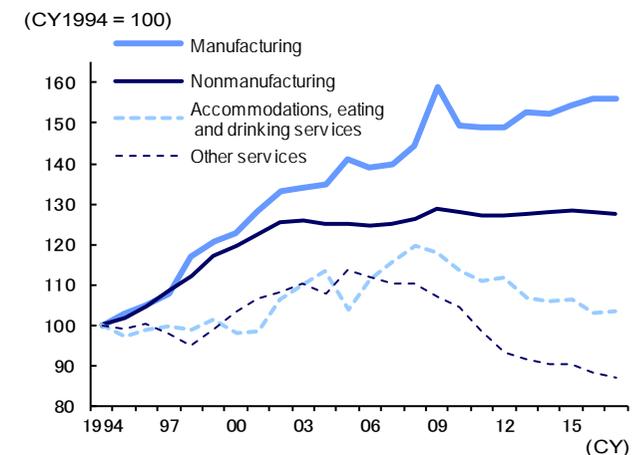
Figure 7-2 Contributions to Real GDP Growth Rate



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

Note: The rising productivity case is based on the assumption that the rate of rise in labor productivity in Japan's nonmanufacturing industries would catch up with those in the U.S. and Germany.

Figure 7-3 Capital Equipment Ratio by Type of Industry



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

Note: The capital equipment ratio = real net capital stock / (the number of workers × hours worked)

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

### ◆ Moderate Economic Recovery Will Continue, Supported by Solid Domestic Demand

(1) Japan's real GDP for the October-December 2018 period increased by 1.4% on an annualized quarter-on-quarter change basis (up 0.3% from the preceding quarter). It returned to positive growth for the first time in two quarters due to a recovery from the negative impact of natural disasters in the summer. However, GDP growth remained lackluster, failing to recoup the decline in the July-September 2018 period (down 2.6% on an annualized quarter-on-quarter change basis). Looking at real GDP by demand item, domestic demand was solid due to higher growth in personal consumption and capital investment. Meanwhile, overseas demand exerted downward pressure on the growth rate, since imports increased thanks to solid domestic demand in addition to weak exports, mainly to China.

(2) As for the future outlook, exports are likely to continue stagnating, since global economic activity, primarily in China, will moderately slow down. Capital spending, mainly by exporting companies, is expected to lose momentum. However, we hold the view that the Japanese economy will continue recovering, led by domestic demand. As many enterprises hesitated to expand production capacity, they still acutely feel the shortage of facilities. Business investments in the fields of labor saving and rationalization are projected to grow steadily against the backdrop of labor shortages. Thus, we think it is unlikely that capital investment will stall.

(3) Meanwhile, personal consumption is also expected to grow gradually, supported by solid income environments. A hike in the consumption tax rate is scheduled for October 2019. However, measures to minimize the impact of the consumption tax rate hike, such as the introduction of a reduced tax rate and provision of free education and nursery care, are expected to reduce the burden on households. Therefore, we believe that a sharp drop in consumer spending is likely to be avoided.

(4) In this revision, we have factored in the effects of measures to ease the impact of the consumption tax rate hike which were incorporated in the government budget for FY2019 that was approved in a Cabinet meeting at the end of 2018. Meanwhile, we have also reflected a larger-than-expected downturn in the global economy. Consequently, we have slightly revised the GDP growth rate for FY2019 from plus 1.0% to plus 0.9%. Although an economic downturn will likely be avoided thanks to solid domestic demand, the Japanese economy is expected to experience moderate growth at around the 1.0%, as high as its potential growth rate.

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

(5) The pace of rise in the core CPI, which excludes fresh food, slowed down mainly because the extent of increase in energy prices narrowed. Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will continue to be slightly less than 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 rise in energy prices will likely continue to decelerate.

Figure 9 Projections for GDP Growth and Main Indicators of Japan ( as of February 14, 2019 )

	CY2018	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)		
		CY2019				CY2020				CY2021	FY2018	FY2019	FY2020
		10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)
(Actual)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	1.4	1.6	2.0	2.3	▲ 3.9	2.3	1.6	2.1	▲ 0.7	1.3	0.5	0.9	0.9
Private Consumption Expenditure	2.4	1.2	1.7	4.4	▲ 8.5	3.8	2.3	2.2	▲ 0.4	1.3	0.7	0.8	0.9
Housing Investment	4.7	1.1	4.2	0.0	▲ 4.5	▲ 3.1	0.8	1.3	1.8	2.0	▲ 4.5	1.2	▲ 0.4
Business Fixed Investment	9.8	1.0	2.7	3.6	▲ 1.9	2.2	2.4	2.4	2.2	2.1	3.2	1.9	1.9
Private Inventories (percentage points contribution)	(▲ 0.8)	( 0.1)	( 0.1)	(▲ 0.4)	( 0.3)	( 0.1)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	(▲ 0.0)	(▲ 0.1)	( 0.0)
Government Consumption Expenditure	3.2	0.2	0.5	0.7	0.7	0.9	1.0	2.2	▲ 1.1	1.2	0.9	0.9	0.9
Public Investment	▲ 4.6	2.9	8.2	▲ 0.5	▲ 1.2	0.2	▲ 2.1	▲ 0.4	0.0	0.0	▲ 3.8	1.3	▲ 0.7
Net Exports (percentage points contribution)	(▲ 1.2)	( 0.5)	(▲ 0.1)	(▲ 0.5)	( 1.0)	(▲ 0.3)	(▲ 0.2)	( 0.1)	(▲ 0.6)	(▲ 0.0)	(▲ 0.2)	(▲ 0.1)	(▲ 0.1)
Exports of Goods and Services	3.7	1.9	2.4	2.2	2.0	1.8	1.8	3.5	▲ 1.7	1.9	1.9	1.8	1.7
Imports of Goods and Services	11.3	▲ 1.0	2.8	4.9	▲ 3.8	3.6	2.7	3.1	1.7	2.1	3.1	2.3	2.1
(Ref.) Domestic Private Demand (percentage points contribution)	( 2.2)	( 0.9)	( 1.6)	( 2.7)	(▲ 4.9)	( 2.4)	( 1.7)	( 1.7)	( 0.2)	( 1.1)	( 0.7)	( 0.7)	( 0.8)
(Ref.) Public Demand (percentage points contribution)	( 0.4)	( 0.2)	( 0.5)	( 0.1)	( 0.1)	( 0.2)	( 0.1)	( 0.4)	(▲ 0.2)	( 0.2)	(▲ 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	1.4	1.5	2.7	1.9	1.6	1.5	1.4	1.9	1.6	0.5	1.9	1.6
GDP deflator	▲ 0.3	0.9	0.8	0.9	1.5	1.0	0.9	0.9	0.6	0.5	0.0	1.0	0.7
Consumer Price Index (excluding fresh food)	0.8	0.8	0.7	0.7	1.0	1.2	1.0	1.1	0.9	0.8	0.8	0.9	0.9
(excluding fresh food, consumption tax, education free of charge)	0.8	0.8	0.7	0.7	0.7	0.8	0.7	0.8	0.9	0.9	0.8	0.7	0.8
Unemployment Rate (%)	2.5	2.4	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.1	2.4	2.3	2.2
Exchange Rates (JY/US\$)	113	110	110	109	108	108	108	107	107	107	111	109	107
Import Price of Crude Oil (US\$/barrel)	78	63	66	68	68	68	68	68	68	68	72	68	68

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.