

Monthly Report of Prospects for Japan's Economy

May 2019

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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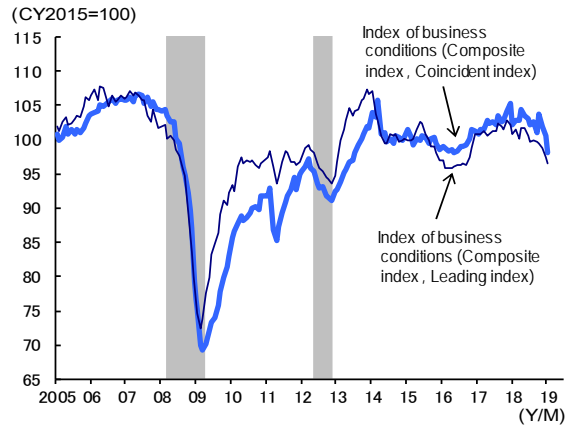
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The General Situation of Japan's Economy – A Sense of Standstill Is Felt in Economic Activity

Figure 1-1 Economic Activity

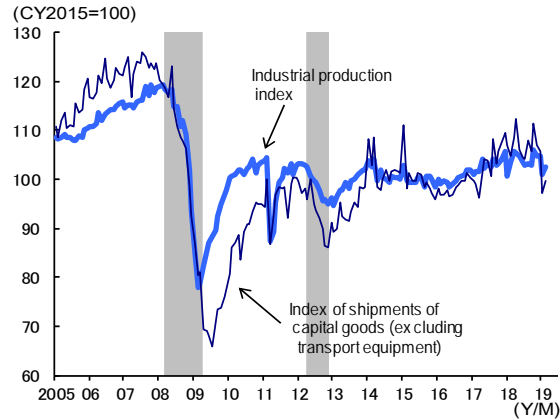
The CI coincident index declined against the backdrop of falling industrial production and shipments.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

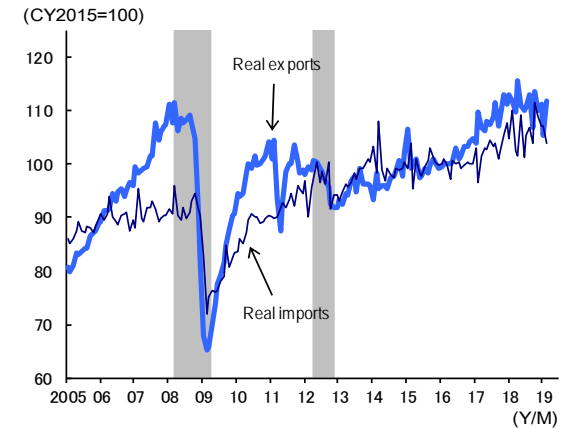
Industrial production slightly increased as exports to China picked up.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

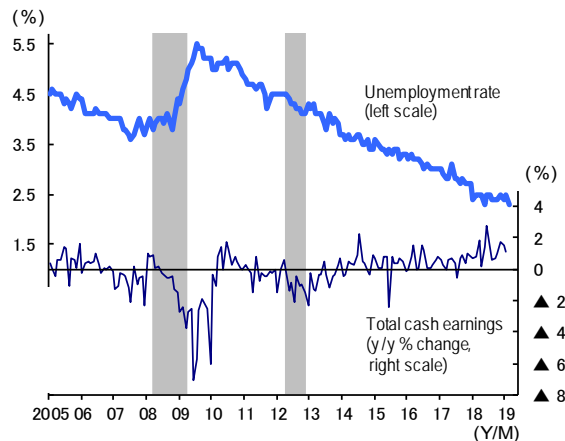
Exports are seesawing due to stagnant exports to Asia. Imports saw a decline.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is hovering around the lowest level since 1993. Nominal wages remained on a rising trend despite fluctuations.

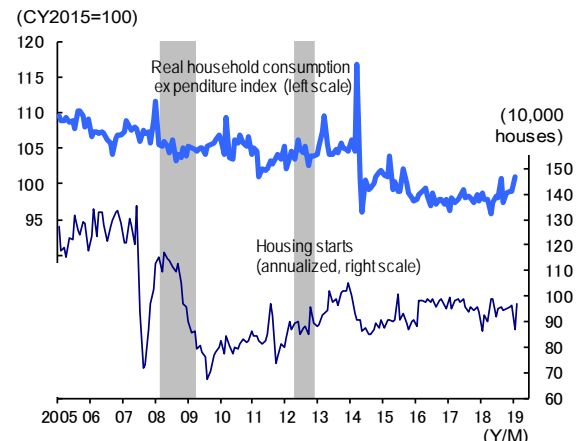


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

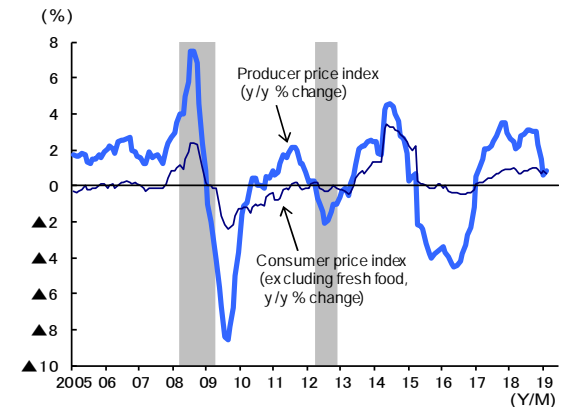
Real household consumption has picked up. Housing starts remained practically flat.



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 has slowed. Consumer prices stayed virtually flat.



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

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Domestic Demand Is Firm, While Overseas Demand Is Sluggish

◆ Industrial Production Has Been Sluggish

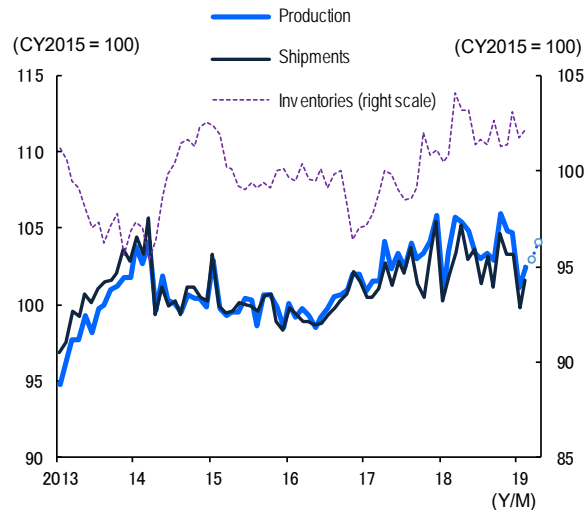
Manufacturing activity appears to have stalled. The industrial production index for February was up 0.7% from the previous month, increasing for the first time in two months. While production saw a decline for aircraft parts and electronic parts, production increased mainly for automobiles and semiconductor manufacturing equipment. However, these increases were not enough to cover the decrease in January (down 2.5% on a month-over-month basis) when industrial production dropped significantly due to a sharp decline in exports to China. The outlook for March is +0.4% on a month-over-month basis (METI's estimate, after correcting for a bias error in the forecasting index) while that for April is +1.1% on a month-over-month basis, indicating bleak prospects for recovery.

◆ The Household Sector Is Making a Mild Recovery

Despite the above, employment and income conditions continued to improve. The unemployment rate in February declined further from the previous month to 2.3%. The active job opening ratio was 1.63 times, indicating that labor supply demand conditions remain tight. Amid a slight increase in the wage growth rate, nominal compensation for employees continued to grow higher.

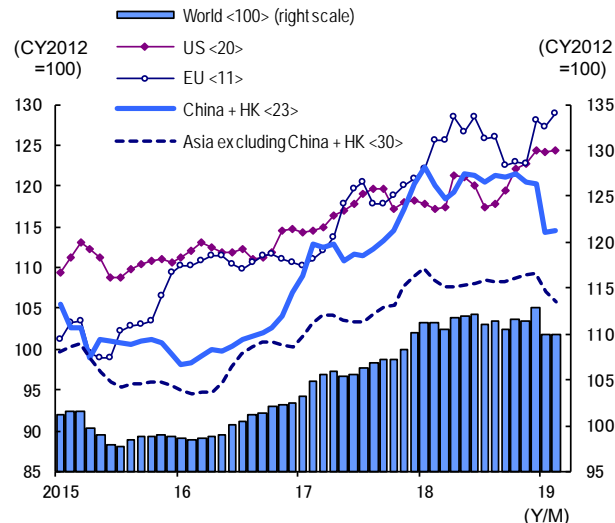
Under such circumstances, private consumption is gradually recovering. Although consumer sentiment is weak against the backdrop of falling share prices, the Synthetic Consumption Index for January was up 0.1% from the previous month, increasing for the second consecutive month and reflecting brisk income conditions.

Figure 2-1 Industrial Production Index
<seasonally adjusted>



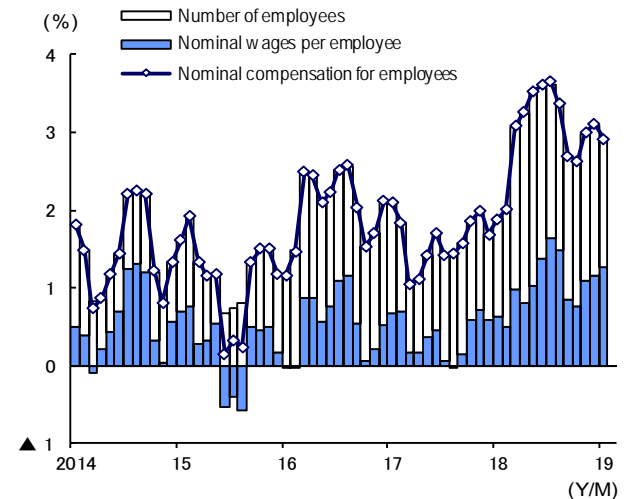
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.
Note: The latest two figures in the industrial production index are forecasts for March and April based on METI's estimate and the production forecast index, respectively.

Figure 2-2 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 CY2018.

Figure 2-3 Nominal Compensation for Employees
<year-on-year % change, 3-month moving averages>



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

BoJ's Tankan Survey - While Business Sentiment Deteriorated, Business Investment Remained Solid

◆ The DI for Business Conditions Turned Downward

In the Tankan March 2019 Survey, large manufacturers' DI for business conditions was down seven percentage points from the previous survey, showing a significant decline. As a result of sluggish exports and production due to the slowdown of the Chinese economy, the DI deteriorated not only in the processing industry, such as general machinery and electrical machinery, but also in the basic materials industry such as chemicals and nonferrous metals.

The DI for large non-manufacturers was also down three percentage points, demonstrating a decline for the first time in two quarters. While business sentiment picked up in the construction and real estate sectors against the backdrop of active urban redevelopment and solid demand for office buildings, the logistics, hotel and food services sectors saw a decline in business sentiment due to the negative impact of growing personnel expenses resulting from labor shortages.

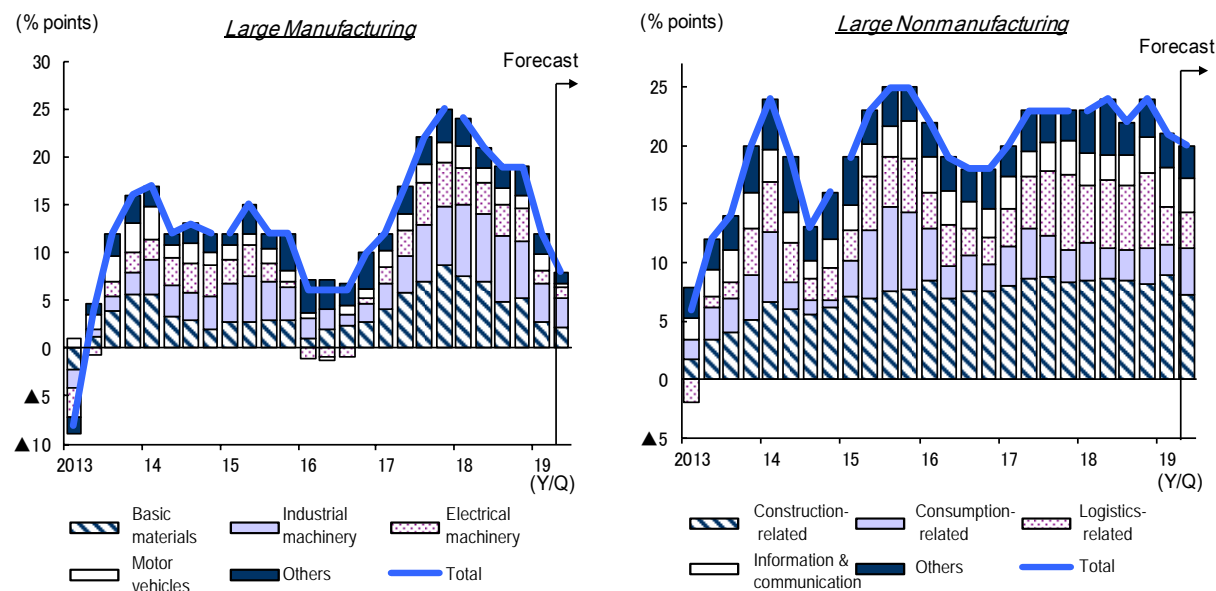
In terms of future outlook, the DI is anticipated to deteriorate, dropping five percentage points across businesses of all sizes and in all industries. Uncertainties remained in the overseas situation owing to the economic slowdown in China and the volatile political landscape in Europe, and these factors will likely apply downward pressure.

◆ Appetite for Business Fixed Investment Is Strong

While business sentiment has deteriorated, the appetite for business fixed investment has remained resilient. The capital investment plan in FY2019 was up 2.0% year on year for the manufacturing industry and down 5.6% year on year for the non-manufacturing industry, indicating a bullish start for the year, following the previous year's high growth. Amid the trend of strong corporate earnings, the capital investment plan is likely to be revised upward gradually in the future. We anticipate that the fiscal year will likely end with a positive year-on-year growth.

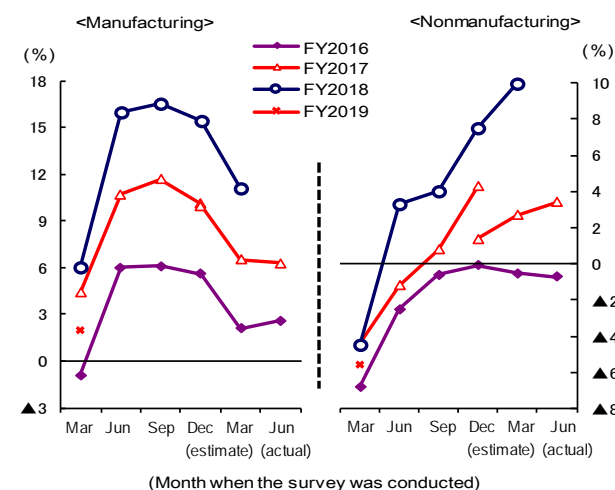
Figure 3-1 Contributions to the Business Conditions Diffusion Index by Industry

<diffusion index of "favorable" minus "unfavorable," and percentage point contribution to total DI points>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan March 2019 Survey".

Figure 3-2 Change over Time in Planned Business Fixed Investment for Each Fiscal Year <year-on-year, %>



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

Note: Including land purchasing expenses, excluding software and R&D investment.

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Exports Are Sluggish

◆ Exports of Goods Have Slowed Down

Exports of goods in February remained weak. While exports of intermediate goods and capital goods to China and ASEAN countries picked up after falling significantly in January, exports of electronic parts and devices were stuck in a decreasing trend as demand remained sluggish globally.

Looking at future prospects, exports are anticipated to pick up, mainly to China, as the economic slowdown in the country will likely come to a halt thanks to economic stimulus measures by the Chinese government. In fact, China's Manufacturing PMI, which is highly correlated to exports to China, quickly picked up after February and exceeded the 50-point mark, which indicates expansion, in March.

Japan-U.S. trade friction remains as a concern. With the start of Japan-U.S. talks

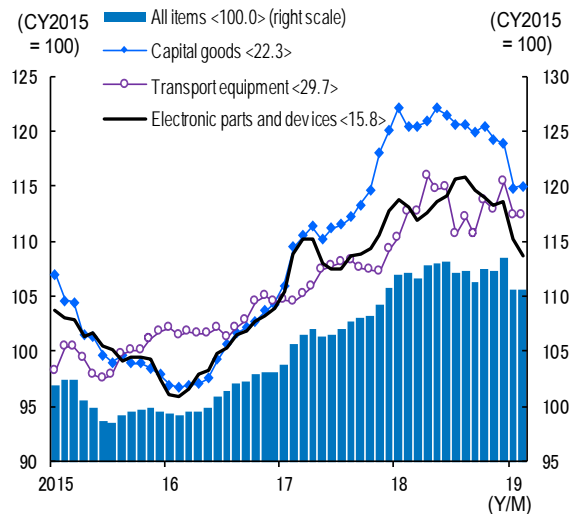
on a Trade Agreement on Goods (TAG), higher automobile tariffs, quantitative restrictions on automobile exports and/or foreign exchange provisions incorporated into this agreement could have a significant impact on Japan's exports.

◆ Demand Related to Inbound Tourism Is Rebounding

Looking at demand related to inbound tourism, both the number of tourists and the amount of consumption have remained at levels exceeding those prior to the slump period that was caused by a series of natural disasters during last year.

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

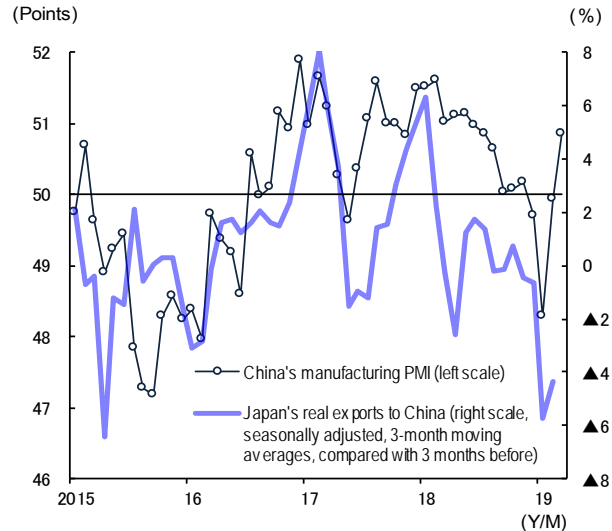
Figure 4-1 Real Exports by Item
<seasonally adjusted,
3-month moving averages>



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

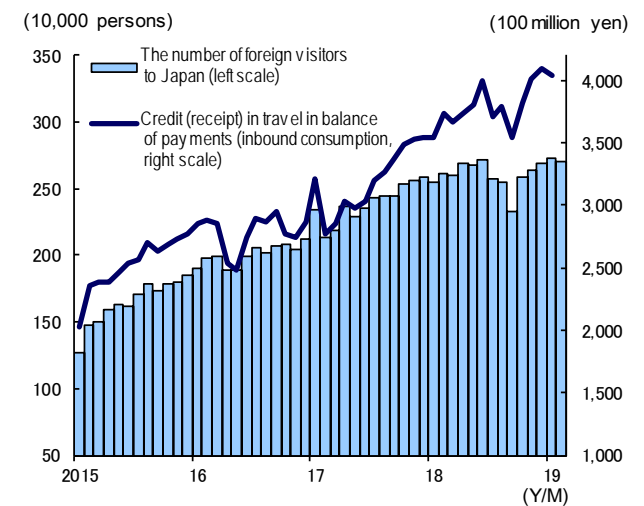
Note: Figures in the angled brackets show the shares in total nominal exports in CY2018.

Figure 4-2 China's Manufacturing PMI
and Japan's Exports to China



Source: The Japan Research Institute, Ltd. based on data of Caixin / IHS Markit, The Ministry of Finance.

Figure 4-3 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).

Corporate Profit Growth and Business Fixed Investment Have Stalled

◆ Momentum in Corporate Profit Growth Has Stalled

While corporate earnings have remained at a high level, a slight sluggishness is currently being observed. According to the Financial Statements Statistics of Corporations by Industry quarterly report, current profits for the period of October-December 2018 declined for the second consecutive quarter, albeit an increase in sales value for the same period for the fifth consecutive quarter. Profits in manufacturing, in particular, saw a substantial drop of 10.6% from the preceding quarter. While the increase in labor costs has been curtailed, a rise in variable costs, due to higher crude oil prices which had continued until the beginning of the fall, pushed down profitability.

Nonetheless, it is unlikely that corporate profits will continue to decline. The future outlook indicates that corporate earnings will likely start increasing again as variable

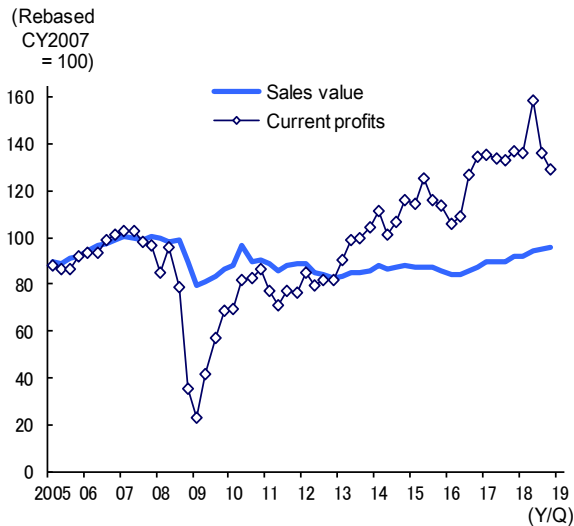
costs are anticipated to start declining due to a drop in crude oil prices. According to the earnings plan of the BoJ's Tankan Survey, current profits are anticipated to improve toward the latter half of FY2019.

◆ Business Fixed Investment Has Stalled

Capital investment has been weak recently. Sluggish overseas demand reflecting the slowing Chinese economy among other factors contributed to the curtailment of capital investment by exporting companies. As the construction of new plants has run its course, machinery orders declined, mainly in the manufacturing sector.

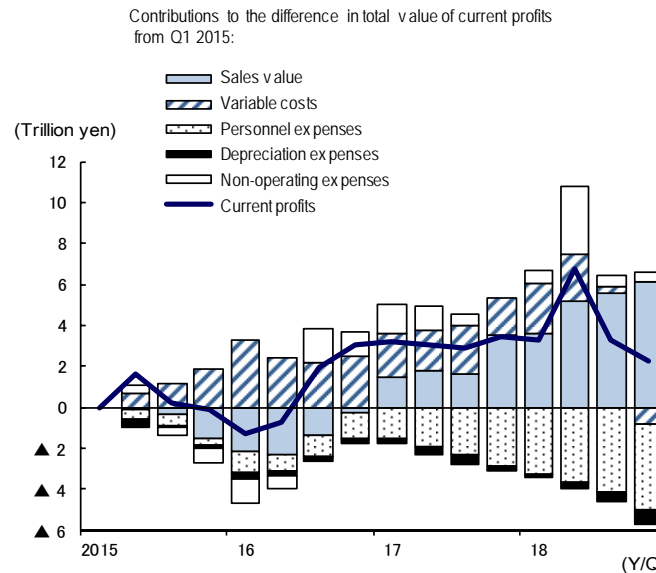
Despite the foregoing, it is very unlikely that capital investment will slump in the future. As concerns over the slowdown of the Chinese economy are wiped out and companies start to implement postponed capital investments, business fixed investment is expected to pick up again.

Figure 5-1 Sales Value and Profits of Japanese Enterprises
<seasonally adjusted>



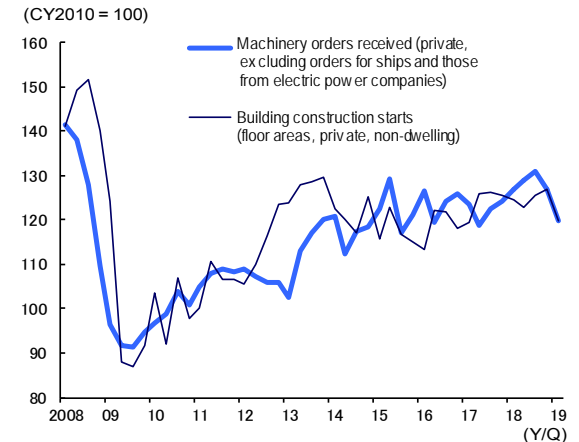
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 5-2 Contributions of Factors to Change in Total Value of Current Profits
<seasonally adjusted>



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

Figure 5-3 Machinery Orders and Building Starts
<seasonally adjusted>



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

Note: The figure in Q1 2019 in machinery orders is for January 2019, and that in building starts is for January-February 2019.

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Income Is Recovering Steadily

◆ Employment and Income Conditions Continue to Improve

The employment situation continues to improve. There has been a notable increase in the number of regular 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 across all industries at a level exceeding those during the bubble economy 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 on an upward trend.

◆ Real Income Is Likely to Increase Firmly

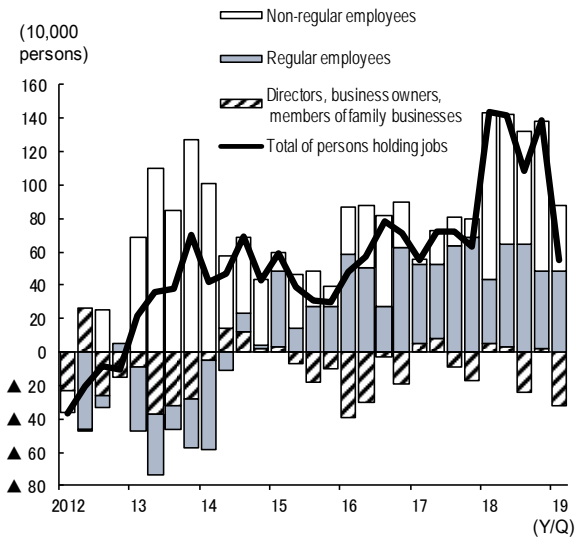
A look at future prospects shows a high likelihood that both the moderate economic recovery and continued population decline will keep labor supply demand conditions

tight. As a result, both employment conditions and nominal wages are expected to continue improving.

The pace of improvement to employment conditions is expected to become moderate gradually. New openings, a leading indicator, have plateaued since the start of 2018 against the backdrop of a decline in the pace of economic recovery among other reasons.

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, because of rising nominal wages and the prospect that provision of free education and nursery care is expected to minimize price increases due to a hike in the consumption tax, growth at around the 2 percent level will likely be maintained.

Figure 6-1 Number of Persons Holding Jobs
<difference from a year earlier>

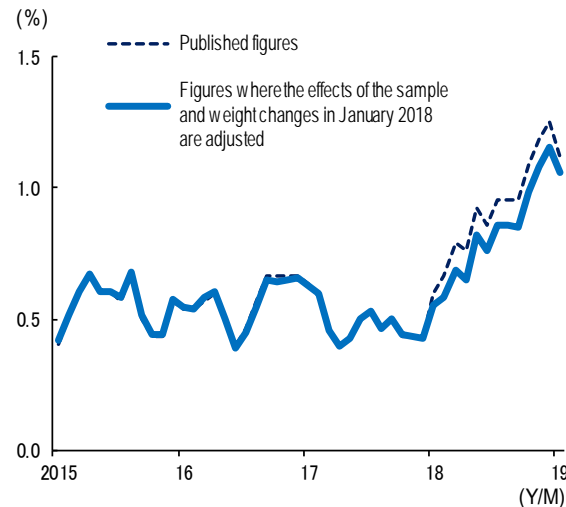


Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labor and Welfare.

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

2. The figures in Q1 2019 are for January-February 2019.

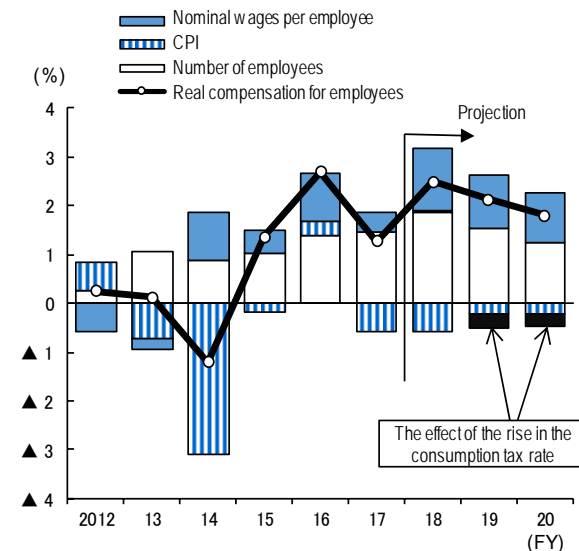
Figure 6-2 Scheduled Salaries for Full-time Workers
<year-on-year % change>



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

Note: 3-month moving averages.

Figure 6-3 Real Compensation for Employees
<year-on-year % change>



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

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Private Consumption Expenditure Is Increasing Moderately

◆ Private Consumption Is Increasing Moderately

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

Warm winter temperatures led to a decline in sales of seasonal merchandise such as winter clothing and food products. In addition, worsening consumer sentiment as a result of a decline in share prices and increasing uncertainties over the economic outlook negatively contributed to lack of strength in private consumption.

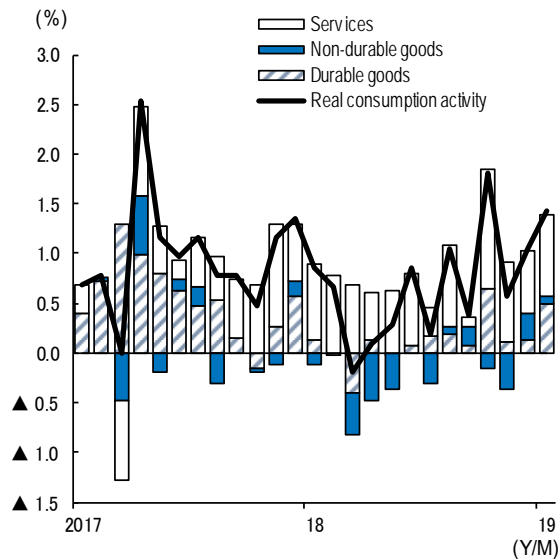
However, service consumption including food service and travel remained on a rising trend, driven by an increase in disposable income. Consumption of durable goods also remained firm. In addition to strong sales of automobiles with the positive

effects of the launch of new vehicle models, there has been replacement demand for refrigerators and TVs which went through a purchasing boom at the time of introduction of the eco-point system ten years ago.

◆ Private Consumption Will Likely Remain on a Mild Recovery Path

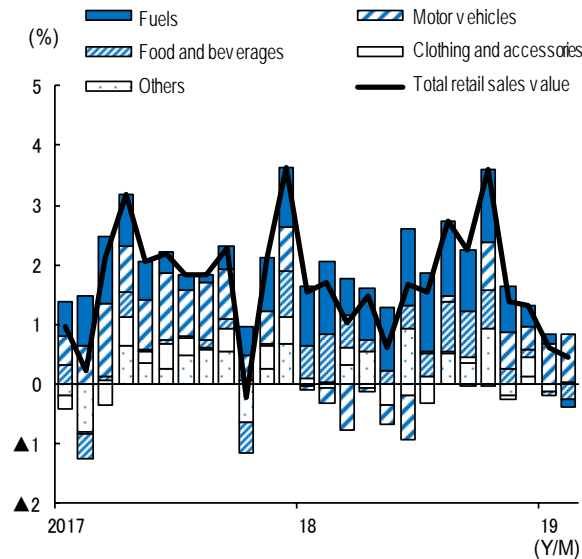
The future outlook shows that private consumption will maintain a mild recovery as employment and income conditions continue to improve, albeit with concerns over the worsening of sentiment reflecting unstable share price movements. Private consumption expenditures will likely return to grow in line with the increase in income if consumer sentiment starts to improve again.

Figure 7-1 BoJ's Consumption Activity Index <year-on-year % change>



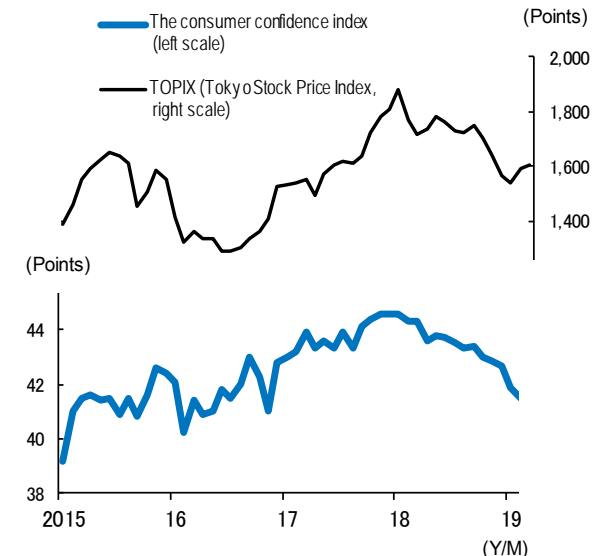
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 7-2 Retail Sales Value by Item <year-on-year % change>



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

Figure 7-3 Consumer Confidence Index and Stock Price Index



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

Topic: What Is the Consumption Trend for Single-person Households?

◆ Positive Effects of Single-person Households on Consumption Growth Have Diminished

According to the National Institute of Population and Social Security Research, the number of single-person households is anticipated to increase by 1.47 million households during the period between 2015 and 2030. The decline in the average number of household members has positive effects on the expansion of macro consumer spending through an increase in consumption amount per capita.

However, such positive boosting effects have been on a diminishing trend in recent years. This reflects the decline in consumption expenditures by single-person households with members aged less than 60 years.

Among single male households, this is mainly attributable to a decrease in disposable income. Since single men cannot expect the support of household income

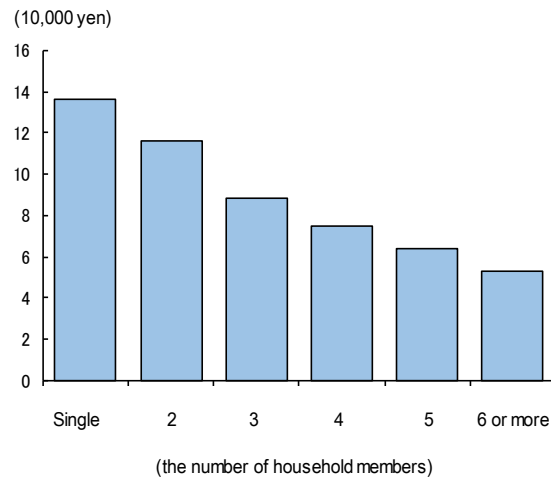
as in the case of double income couples, they are directly faced by the pressure of wage reduction by companies.

Among single female households, this is primarily attributable to a significant decline in consumption propensity. Since the income level for women is relatively lower than that for men, a sense of insecurity about their future lives tends to be amplified as a result of delaying or forgoing marriage.

◆ Sluggish Consumption by Single-person Households Will Likely Continue

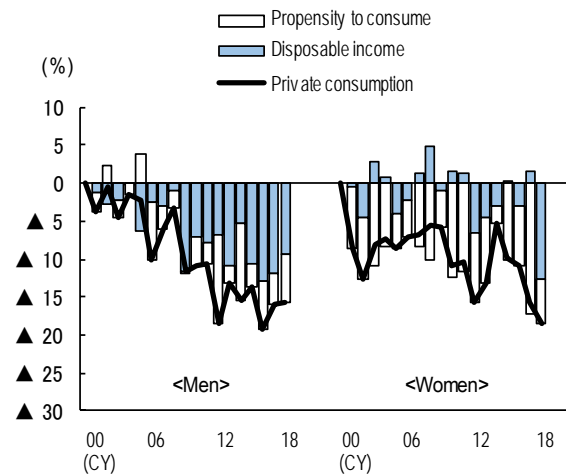
Looking at future prospects, there is little hope for a rapid recovery in consumption by single-person households. As for single male households, while employment and income conditions have been improving at a macro level, a rise in the ratio of non-regular employment will put downward pressure on income. In respect to single female households, amid the ongoing trend of delaying or forgoing marriage, stagnant consumption propensity will likely be prolonged.

Figure 8-1 Monthly Consumption Amount per Capita by Group of the Number of Household Members



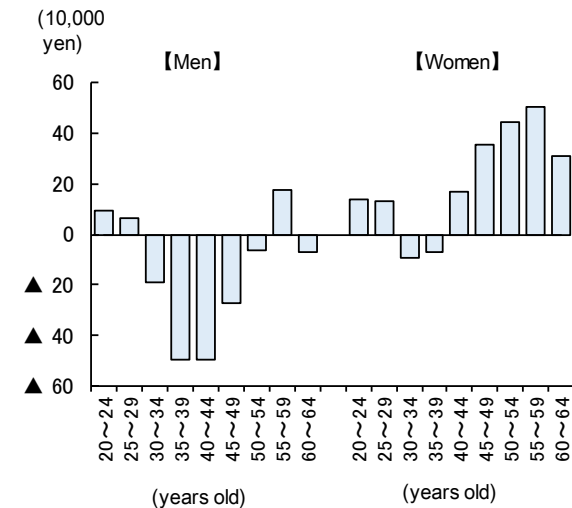
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note: The figures are the averages from CY2014 to CY2018.

Figure 8-2 Changes in Consumption by Working Single-person Households with Members Aged Less Than 60 Years



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note: The figures are accumulated change rates since CY2000.

Figure 8-3 Changes in Annual Salaries of Full-time Workers <CY2000 → CY2017>



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

Prospects for Japan's Economy - Projected Real GDP Change; 0.8% in FY2019 and 0.9% in FY2020

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

(1) As for the future outlook, exports are likely to continue stagnating against the backdrop of moderate slowdown of the global economy. Capital spending, mainly by exporting companies, is also 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 will 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 significantly.

In addition, Japan's economy will likely be underpinned by an increase in public investment in the future as a result of the execution of the supplementary budget for FY2018.

(2) Meanwhile, looking at the household sector, personal consumption is also expected to grow mildly, supported by a solid income environment. A hike in the consumption tax rate is scheduled for October 2019. However, the hike of the tax rate will be smaller than that in 2014 and the burden on households is expected to be reduced thanks to 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. Therefore, we believe that a sharp drop in consumer spending is likely to be avoided.

As a result of the above, the Japanese economy is expected to grow moderately for FY2019 and FY2020 at around the 1.0% level, which is close to its potential growth rate.

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

(3) The pace of rise in the core CPI, which excludes fresh food, decelerated slightly 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 10 Projections for GDP Growth and Main Indicators of Japan (as of April 3, 2019)

	(seasonally adjusted, annualised % changes from the previous quarter)										(% changes from the previous fiscal year)		
	CY2018	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)	(Projection)
	(Actual)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	1.9	0.5	1.8	2.6	▲ 3.7	2.3	1.6	2.2	▲ 0.9	1.3	0.6	0.8	0.9
Private Consumption Expenditure	1.6	1.2	1.8	4.4	▲ 8.5	3.9	2.2	2.4	▲ 0.9	1.3	0.6	0.8	0.8
Housing Investment	4.6	3.4	3.2	0.0	▲ 4.5	▲ 3.1	0.8	1.3	1.8	2.0	▲ 4.3	1.4	▲ 0.4
Business Fixed Investment	11.3	▲ 1.7	2.2	3.9	▲ 1.6	2.2	2.4	2.4	2.2	2.1	3.3	1.6	1.9
Private Inventories (percentage points contribution)	(0.1)	(▲ 0.3)	(0.0)	(▲ 0.4)	(0.3)	(0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(0.1)	(▲ 0.0)	(0.0)
Government Consumption Expenditure	3.0	0.4	0.6	0.7	0.7	0.9	1.0	2.2	▲ 1.1	1.2	0.9	0.9	0.9
Public Investment	▲ 6.8	2.9	8.2	2.9	0.4	▲ 1.8	▲ 2.1	▲ 0.2	0.0	0.0	▲ 4.3	1.8	▲ 0.7
Net Exports (percentage points contribution)	(▲ 1.2)	(0.1)	(▲ 0.1)	(▲ 0.4)	(1.1)	(▲ 0.3)	(▲ 0.2)	(0.0)	(▲ 0.5)	(▲ 0.0)	(▲ 0.2)	(▲ 0.2)	(▲ 0.0)
Exports of Goods and Services	4.0	▲ 2.5	2.3	2.6	2.6	2.0	1.5	3.2	▲ 1.7	1.8	1.7	1.2	1.7
Imports of Goods and Services	11.3	▲ 2.8	2.9	4.9	▲ 3.8	3.7	2.5	3.1	1.3	2.1	3.0	2.0	2.0
(Ref.) Domestic Private Demand (percentage points contribution)	(2.8)	(0.2)	(1.5)	(2.7)	(▲ 4.9)	(2.5)	(1.7)	(1.8)	(▲ 0.1)	(1.1)	(0.8)	(0.7)	(0.8)
(Ref.) Public Demand (percentage points contribution)	(0.2)	(0.2)	(0.5)	(0.3)	(0.2)	(0.1)	(0.1)	(0.4)	(▲ 0.2)	(0.2)	(▲ 0.0)	(0.3)	(0.1)

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	▲ 0.1	1.2	1.3	2.6	1.7	1.6	1.6	1.4	1.8	1.6	0.6	1.8	1.6
GDP deflator	▲ 0.3	0.8	0.7	0.9	1.5	0.9	0.9	0.9	0.5	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 (%)	2.4	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	111	110	109	109	108	108	107	107	111	110	108
Import Price of Crude Oil (US\$/barrel)	77	64	68	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.