

# Monthly Report of Prospects for Japan's Economy

## December 2023

Macro Economic Research Center  
Economics Department



The Japan Research Institute, Limited

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

**This report is the revised English version of the November 2023 issue of the original Japanese version.**

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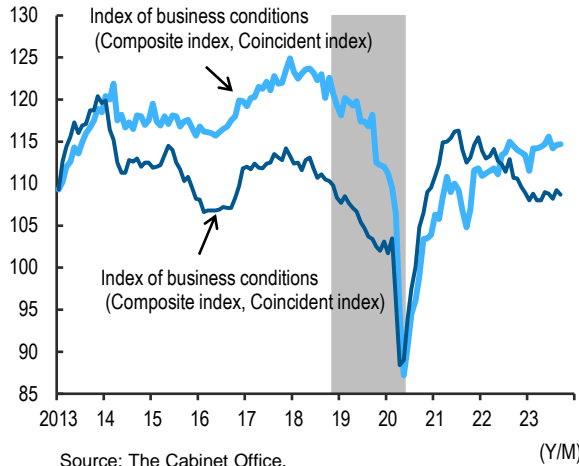
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# The General Situation – The economy is gradually recovering

**Figure 1-1 Economic Activity**

The coincident index of business conditions is improving.  
The leading index remains unchanged.

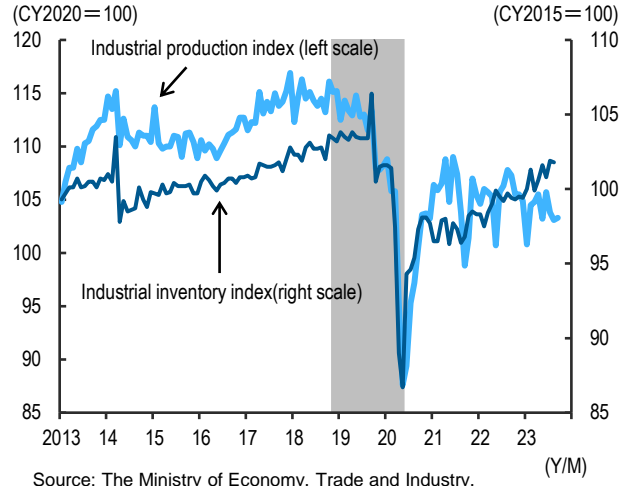
(CY2020=100)



**Figure 1-2 The Corporate Sector**

Industrial production is fluctuating.  
Economic activity in the service sector is recovering.

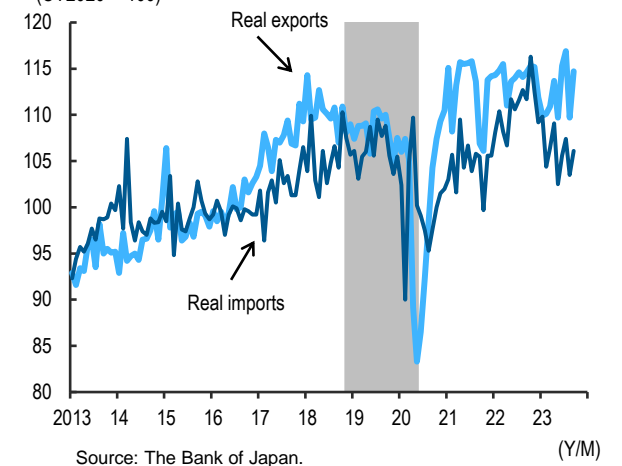
(CY2020=100)



**Figure 1-3 Overseas Demand**

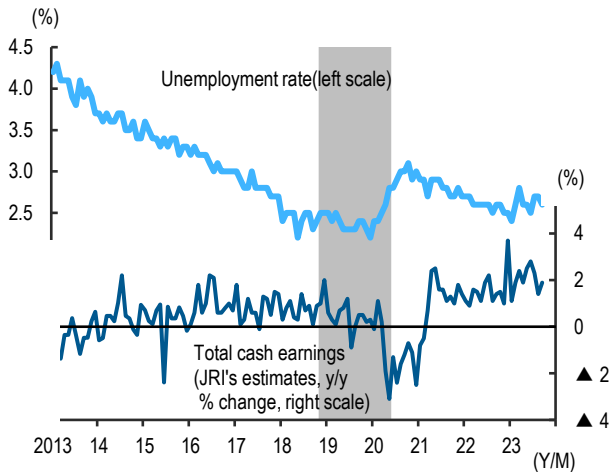
Exports, particularly of automobiles, are increasing.  
Imports, especially energy-related, are falling.

(CY2020=100)



**Figure 1-4 Employment and Income**

The unemployment rate is hovering around the mid-2% range.  
Nominal wage growth stands at around 2%.



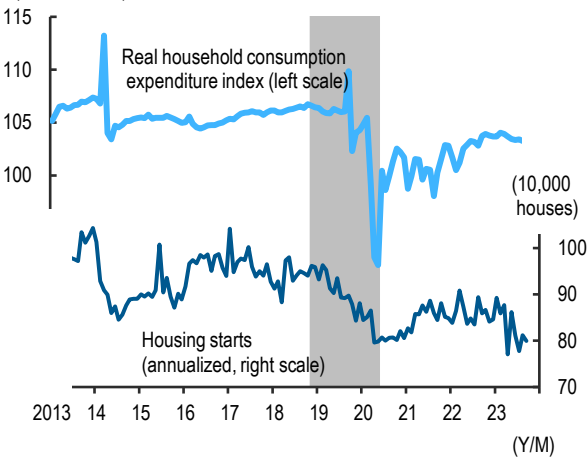
Source: The Ministry of Internal Affairs and Communications,  
The Ministry of Health, Labor and Welfare.

\* The shaded area indicates the recession phase.

**Figure 1-5 The Household Sector**

Consumption is gradually rising.  
Housing starts are currently weak.

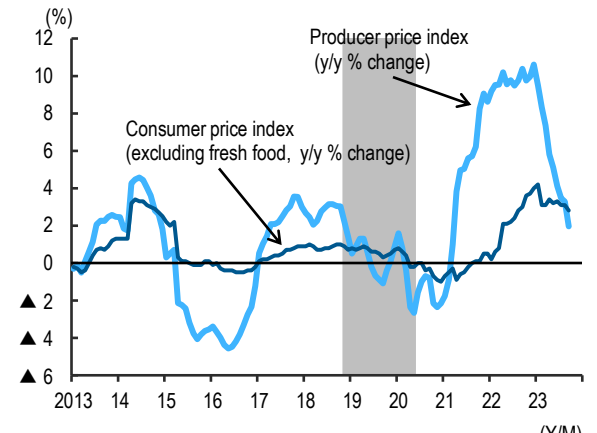
(CY2020=100)



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

**Figure 1-6 Prices**

Corporate price inflation is slowing rapidly.  
Consumer price inflation remains around 3%.



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

# Economic activity in the service sector is becoming brisker

## ◆ Economic activity in the service sector is becoming brisker

In September, the Industrial Production Index increased for the first time in three months, rising 0.2% from the previous month. By industry, production machinery, electrical machinery, and information and communication electronics equipment saw decreases, while automobiles saw a rise in reaction to the previous month's drop in production due to plant shutdowns by automakers.

Near-future production plans indicate an increase in output in October (+3.9% month on month (MoM)) and a decrease in November (-2.8% MoM). However, there were further plant shutdowns by some automakers in October, which could lead to a downswing in production of transportation machinery despite plans to boost output.

## ◆ Business activity in the non-manufacturing sector is recovering

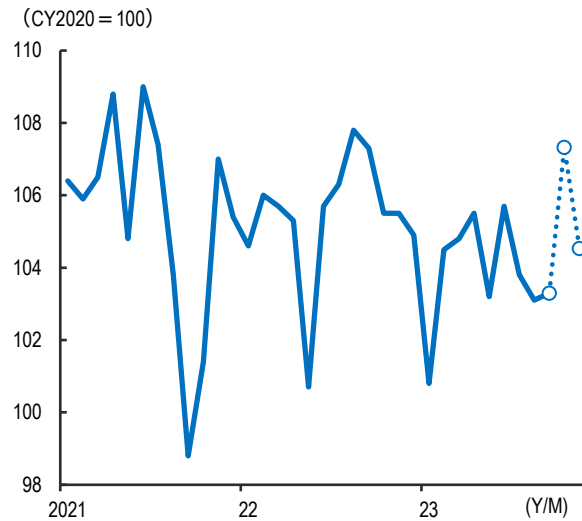
In August, the Tertiary Industry Activity Index fell for the first time in two months, decreasing 0.1% from the previous month. Face-to-face services such as living and amusement-related services continued to bounce back on the back of recovering

inbound tourism demand and increased opportunities to get out and about, while activity in business-related services such as job placement and worker dispatch services also improved thanks to a rise in the number of workers being sought. On the other hand, transportation/postal sector activity, which declined sharply in reaction to the previous month's rise, pushed down the overall index.

## ◆ The improvement in business confidence has paused

The diffusion index (DI) for current economic conditions in the Economy Watchers Survey for October dropped for the third consecutive month, falling 0.4 points from the previous month. Breaking this down, the DI for household activity remained unchanged, but that for corporate activity declined due to soaring raw material and labor costs.

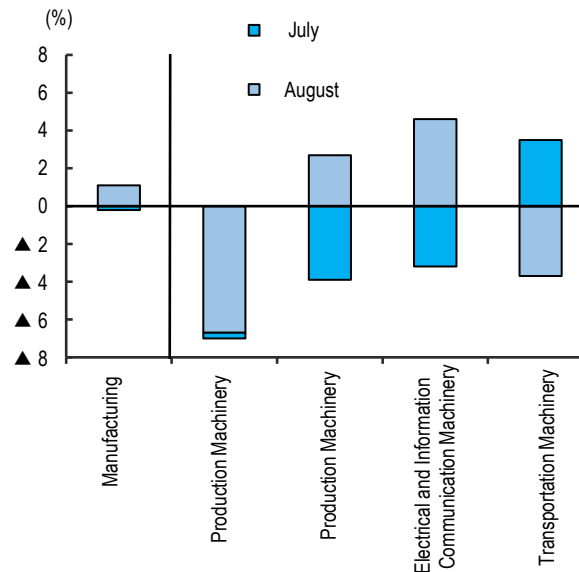
Figure 2-1 Industrial Production Index



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

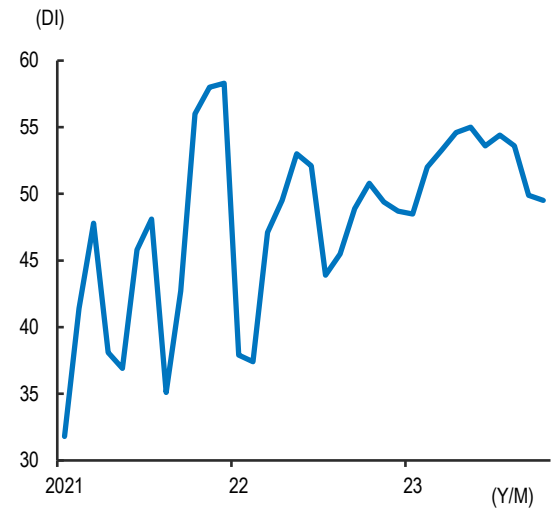
.Note: Dotted lines are postponed based on the forecast index of manufacturing production (October and November).

Figure 2-2 Production Plan by Industry <MoM>



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

Figure 2-3 Business Watchers Survey <DI for current situation, seasonally adjusted>



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

## Goods exports are sluggish, but inbound tourism demand continues to recover

### ◆ Goods exports increased from the previous month

In September, real exports rose for the first time in two months. By product category, exports of electronic components and devices were sluggish due to a dip in IT-related demand, but higher exports of transportation machinery, whose output has been recovering, supported goods exports overall.

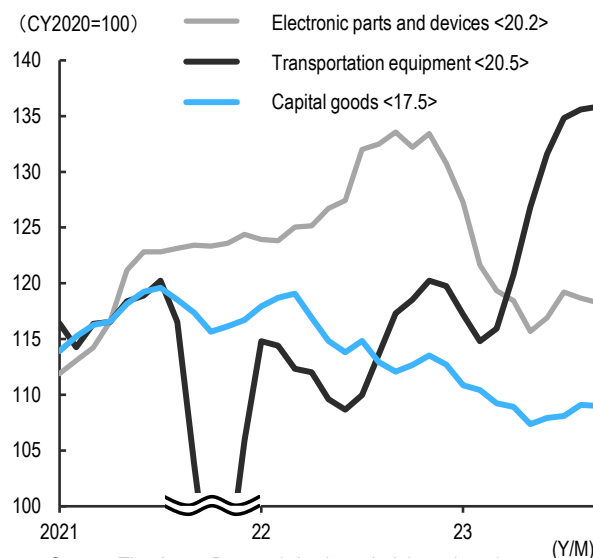
Looking ahead, goods exports are likely to be lackluster, against a backdrop of weak global demand for goods. Exports to Western countries, where the effects of monetary tightening are expected to become apparent, are projected to see a deceleration, and exports to China, where the economic recovery is weak because of such factors as the correction in the real estate market, look set to remain sluggish. The new export orders index remained below 50, which is the dividing line between improvement and deterioration.

### ◆ The number of foreign visitors to Japan exceeds 90% of the pre-COVID level

The number of foreign visitors to Japan in September rebounded to over 90% of the 2019 level, with 2.18 million travelers coming to Japan. Although tourists from China have been slow to return, with the number reaching only about 40% of the 2019 level, the number of visitors from countries other than China has now topped the pre-COVID figure. Spending by visitors to Japan in the July-September quarter rose to beyond the 2019 figure. Factors such as yen depreciation mean prices in Japan seem cheap to foreign tourists, resulting in higher per-person spending on accommodations and other items.

Going forward, inbound tourism demand should continue its recovery. There is plenty of room of recovery in the number of visitors from China, so Chinese travelers to Japan should also increase in number. However, given China's lackluster economy and political developments surrounding the release of treated water from the Fukushima Daiichi nuclear power plant, the pace of recovery in the Chinese

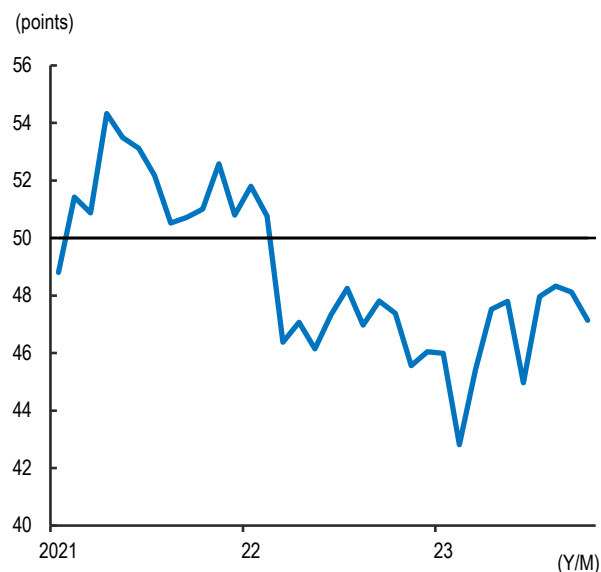
Figure 3-1 Real Export by Area  
<seasonally adjusted>



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

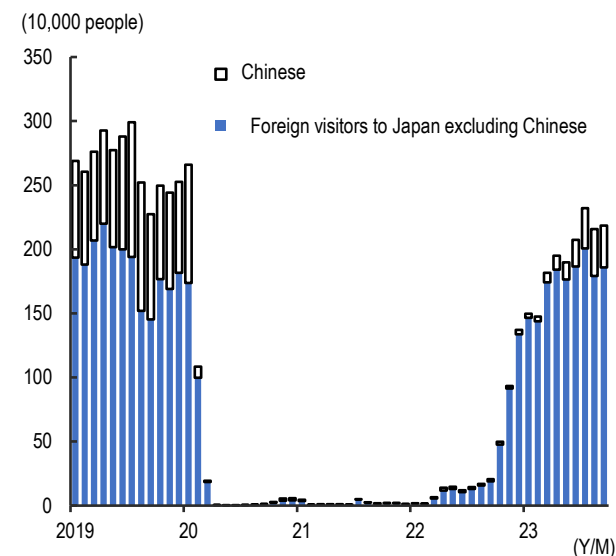
Note: <->Figures in parentheses represent the share of total nominal exports in 2022.Backward 3-month moving average.

Figure 3-2 New Export Orders Index



Source: The Japan Research Institute, Ltd. based on data of The S&P Global.

Figure 3-3 Number of Foreign Visitors to Japan  
Trends in



Source: The Japan Research Institute, Ltd. based on data of The Japan National Tourism Organization.

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# Capital investment will continue to increase thanks to strong corporate earnings

## ◆ Corporate earnings remain at high levels

According to the Financial Statements Statistics of Corporations, ordinary profit for the April-June quarter increased 9.5% from the previous quarter across all industries, rising for the second consecutive quarter. Ordinary profit as a percentage of net sales was over 7%, its highest level ever. Rebounded demand in the automobile and face-to-face service sectors boosted operating profit, and non-operating profit also climbed thanks to such factors as higher dividend income from overseas subsidiaries as the yen depreciated.

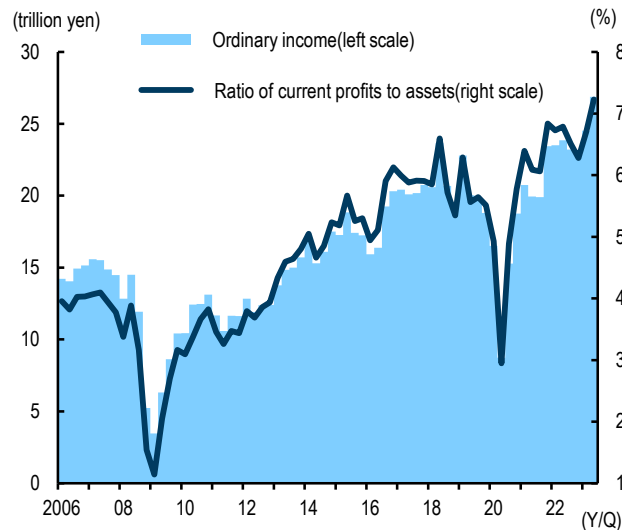
Looking ahead, corporate earnings are expected to remain high overall. In the Bank of Japan's September Tankan survey, companies in a wide range of industries, particularly lodging and food/beverage services, raised their ordinary profit forecasts for this fiscal year. Earnings are expected to continue to rise for the time being, with non-manufacturing earnings the primary contributor as services consumption by Japanese consumers and foreign tourists still has further room for recovery.

## ◆ Capital investment is maintaining its upward trajectory

Capital investment slowly increased. Looking at capital investment by type, construction investment was weak due to factors such as higher construction costs, but software investment remained brisk. Machinery investment, which had been declining, bounced back.

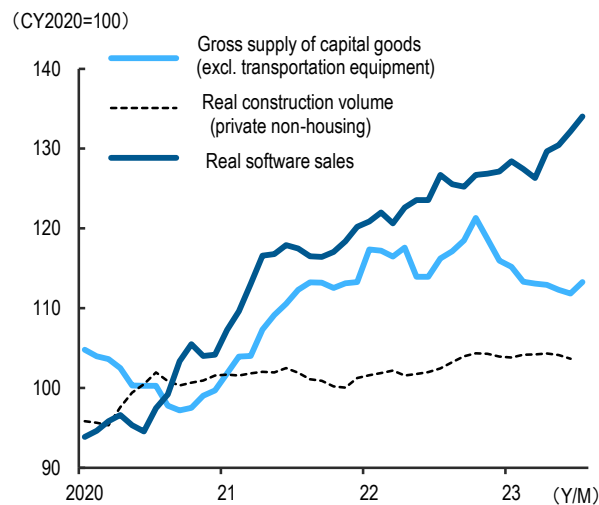
Capital investment is also expected to hold firm going forward. According to a survey of projections for the July-September Financial Statements Statistics of Corporations, companies are maintaining a proactive stance toward capital investment, with appetite for digital investment for labor-saving and data-related applications particularly strong. In addition, an examination of the global silicon cycle and capital investment cycle suggests that the downturn is currently bottoming out, and demand for capital investment to expand production capacity is expected to increase in the near term.

Figure 4-1 Ordinary Income and Return on Sales <seasonally adjusted>



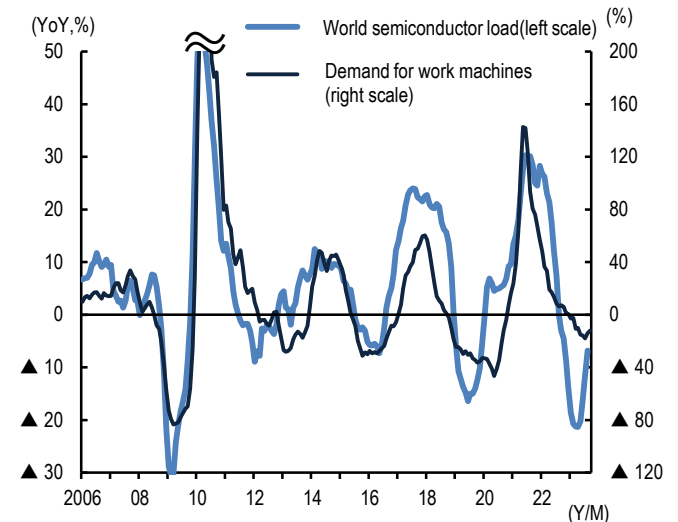
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.  
Note: Excluding finance and insurance.

Figure 4-2 Private Capital Investment Indicators <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.  
Note: Backward 4-month average.

Figure 4-3 World Semiconductor Shipments and Machine Tool Orders External Demand



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office and WSTS.  
Note: Backward 3-month moving average.

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# The employment/income situation is gradually improving

## ◆ The number of workers is rising gradually

The unemployment rate for September was 2.6%, down from the previous month. The number of involuntary unemployed people has fallen recently. The number of workers increased 0.1% MoM for the second consecutive monthly rise. By industry, the higher headcounts are being driven by face-to-face services such as lodging and food/beverage services, where demand is recovering.

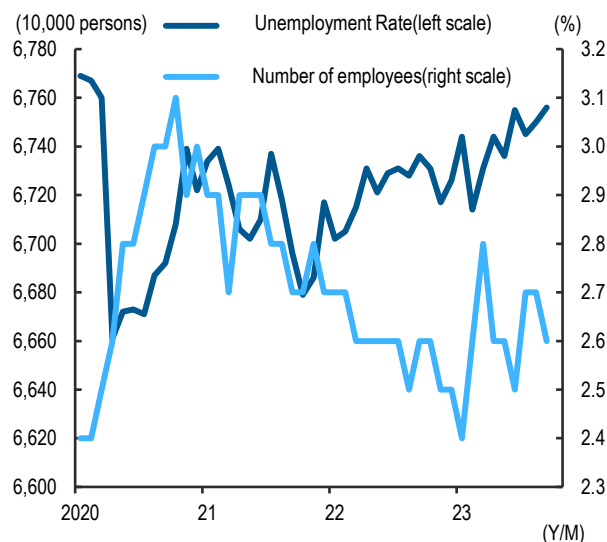
The job market is expected to become increasingly tight going forward. Demand for labor will increase as economic activity recovers, but there is limited room for expansion in the labor supply. Regarding the size of the labor force, the number of elderly workers has already peaked, and growth in female workforce participation has also slowed compared to before the pandemic.

## ◆ The rate of nominal wage growth is rising

In September, basic salaries of regular employees increased by 2.0% YoY, and the hourly pay of part-time workers also climbed 3.6% YoY, rising at a faster pace though with some fluctuation. By industry, wage growth tended to be higher in sectors facing serious labor shortages, such as lodging and food/beverage services and transportation/postal services. However, the rises did not keep pace with the rate of price increases, with real wages falling 2.4% for the 18th consecutive month of negative growth.

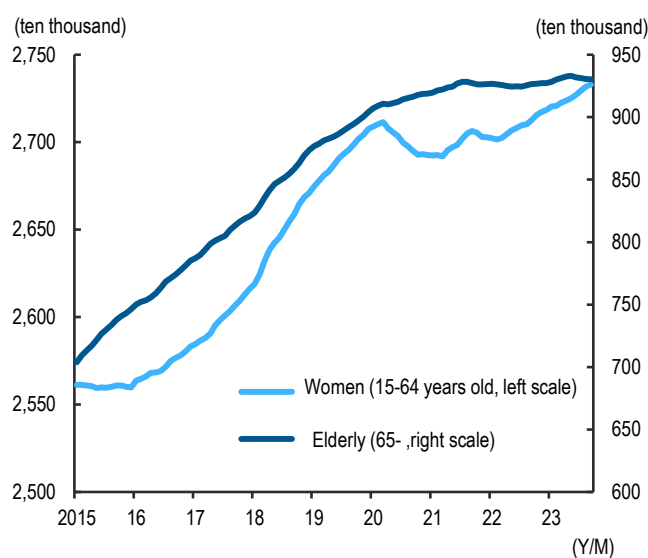
Going forward, real wage growth is expected to turn positive during 2024. Wage growth rates look set to accelerate in a wide range of industries as labor shortages intensify and minimum wages rise. However, if oil prices remain high for the long term, a slump in real wages is highly likely. Higher oil prices not only push up consumer prices, but also suppress nominal wage growth by reducing corporate earnings.

Figure 5-1 Unemployment Rate and The Number of Workers



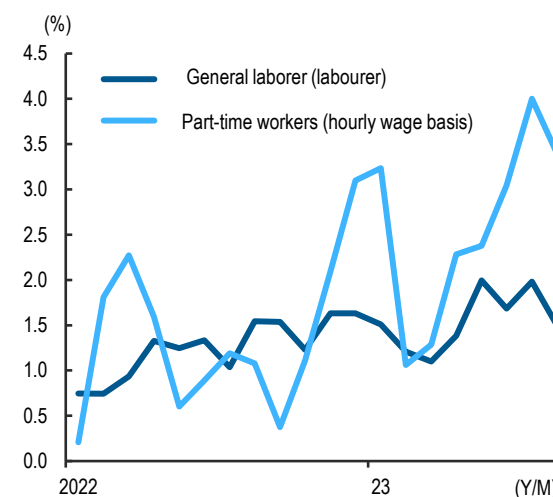
Source: The Japan Research Institute, Ltd. based on the data of Ministry of Internal Affairs and Communications.

Figure 5-2 Labor Force <backward 12-month moving average>



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

Figure 5-3 Basic Salaries <YoY>



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

Note: Adjusted for data fault caused by the replacement of surveyed companies.

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# Personal consumption is gradually recovering, and an improving income environment will provide support going forward

## ◆ Services consumption is slowly increasing

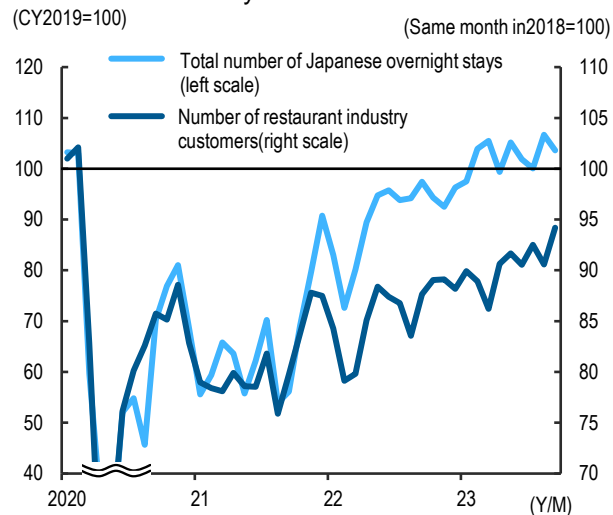
Personal consumption is gradually recovering despite weakness in certain categories. The normalization of economic activity has led to a moderate increase in consumption of services such as dining out and travel. In dining out, customers have finally begun to return, albeit gradually, to izakayas (traditional Japanese pubs). As for goods, consumption of non-durable goods such as clothing and footwear weakened due to the impact of rising prices, though automobile purchases increased as supply constraints eased.

## ◆ Risk of downswing in personal consumption due to rising oil prices

Personal consumption, particularly of services, is expected to continue its gradual recovery going forward. For the time being, rebounded demand for services such as dining out will drive the recovery. And even after this rebounded demand peters out, the recovery in personal consumption is expected to be maintained, supported by an improved income environment. According to estimates, a 1% increase in real income lifts personal consumption by 0.8%. Breaking this down, the expansionary effect on spending is slightly greater for services than goods.

However, if oil prices rise further, there is a risk of a downturn in personal consumption due to sluggish real wages. Estimates suggest that if crude oil prices rise to their most recent peak (\$130 a barrel), personal consumption would fall by 0.2% in the first year and 0.5% in the second year.

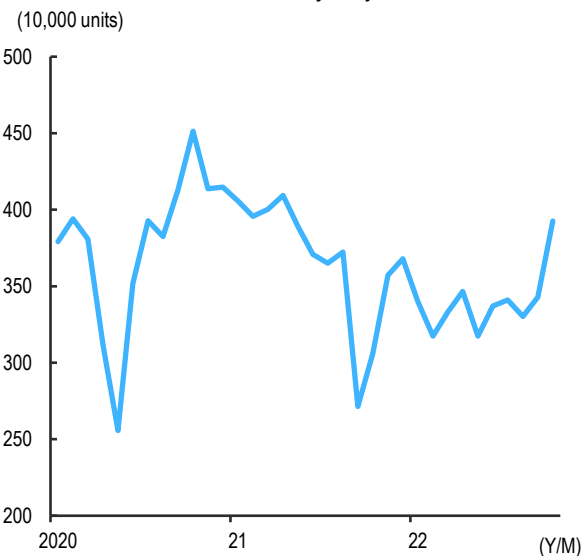
Figure 6-1 Number of Hotel Guests and Restaurant Industry Customers



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

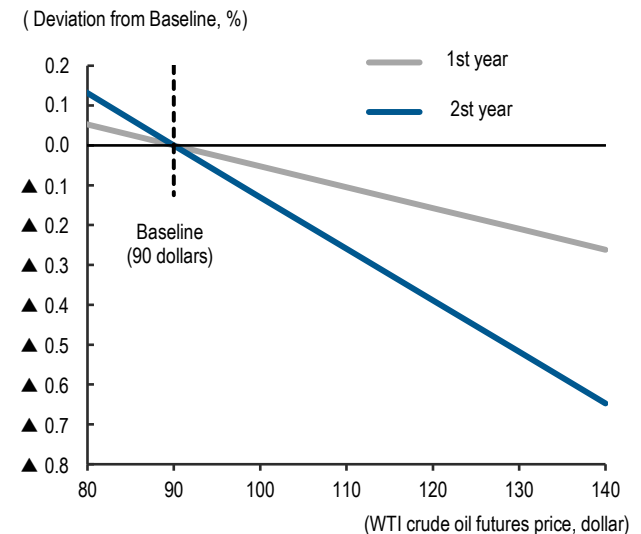
Note: The number of restaurant industry customers (right scale) is 100 for the same month of 2018 in order to eliminate the impact of rush demand associated with the consumption tax hike.

Figure 6-2 New Vehicle Registrations <seasonally adjusted, annualized>



Source: The Japan Research Institute, Ltd. based on data of The Japan Mini Vehicles Association, Japan Automobile Dealers Association.

Figure 6-3 Impact of Crude Oil Prices on Personal Consumption



Source: The Japan Research Institute, Ltd. based on data of The Nihon Keizai Shimbun, Inc.

Note: Estimated based on NEEDS Japan economic model.

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# Topic①: Construction investment in the manufacturing sector is increasing on the back of semiconductor-related investment

## ◆ Appetite for construction investment in the manufacturing sector is strong

Private-sector construction orders (50 largest companies) in the manufacturing sector have been increasing at an accelerating pace since last year. The annual growth is now in the three trillion yen range, the highest level since the bubble era. The breakdown reveals that higher orders for factories and power plants are the driving force.

Increased demand for semiconductor-related factory construction can be pointed to as a background factor. Government subsidies and the global trend toward decentralization of semiconductor production facilities in response to heightened geopolitical risks are providing a tailwind. Construction orders in the electrical machinery sector, which include those related to semiconductors, have nearly doubled from their pre-COVID level.

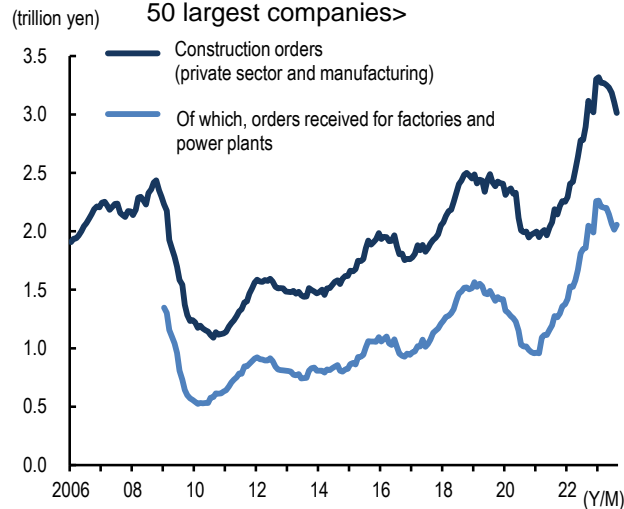
## ◆ Labor shortages have become a bottleneck

However, the increase in demand is not translating directly into completed

construction projects. The floor area of industrial building starts bottomed out in 2010, but the subsequent recovery was lackluster, and the figure remains at a low level. Recently, the volume of construction work still sitting unfilled in order books has reached a record high level.

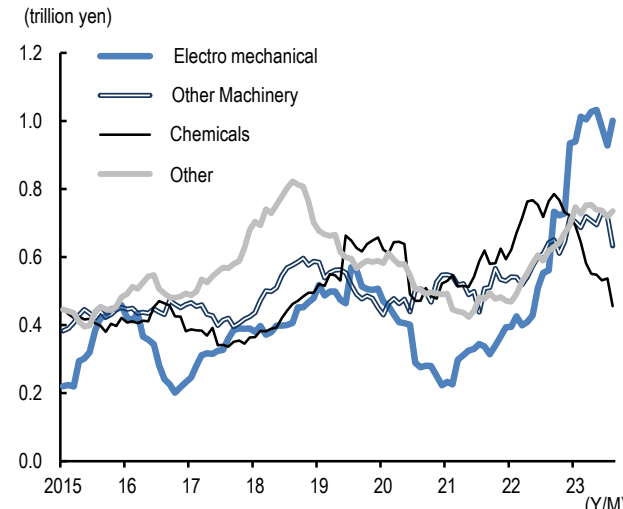
This may be due to supply constraints caused by labor shortages. In a survey of construction companies nationwide, labor shortages were cited as the biggest headache for management. According to the Bank of Japan's September Tankan survey, the diffusion index (DI) for employment conditions in the construction industry slumped to its lowest level since the bubble, indicating that labor shortages have become a serious problem. In addition, labor shortages could become even more severe from FY2024, when construction becomes subject to new caps on overtime hours. The construction sector had previously enjoyed a temporary exemption from the limits. To eliminate the bottleneck in construction investment, securing the workforce and improving productivity, needed to expand capacity, are urgent tasks.

Figure 7-1 Construction Orders Received by The Manufacturing Industry <private sector, 50 largest companies>



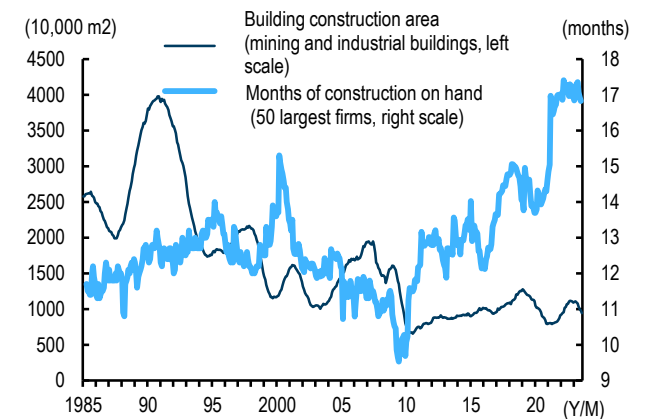
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure, Transport and Tourism  
 Note: Annualized, backward 12-month moving average. Factories and power plants since 2009.

Figure 7-2 Manufacturing Construction Orders <private sector, by industry>



Source: The Japan Research Institute, Ltd. based on data of The Japan Federation of Construction Contractors Associations.  
 Note: Annualized, backward 12-month moving average. Note: Annualized, backward 12-month moving average.

Figure 7-3 Floor Space of Construction Starts in The Mining Industry and The Number of Months of Construction Work in Hand in The Construction Industry



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure, Transport and Tourism.  
 Note: Construction floor area is annualized, backward 12-month moving average.

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## Topic②: Higher floating mortgage rates are putting downward pressure on consumption

### ◆ Expectations of short-term interest rate hikes are becoming more widespread

OIS (overnight index swap) rates, which reflect market participants' policy rate expectations, have been rising recently, with the one-month rate on one-year forward contracts climbing above 0.3%. This suggests that many market players think rates will be pulled out of negative territory and hiked by at least 0.25% over the next year.

### ◆ The suppressive effect on consumption will be 2.4 times greater than 20 years ago

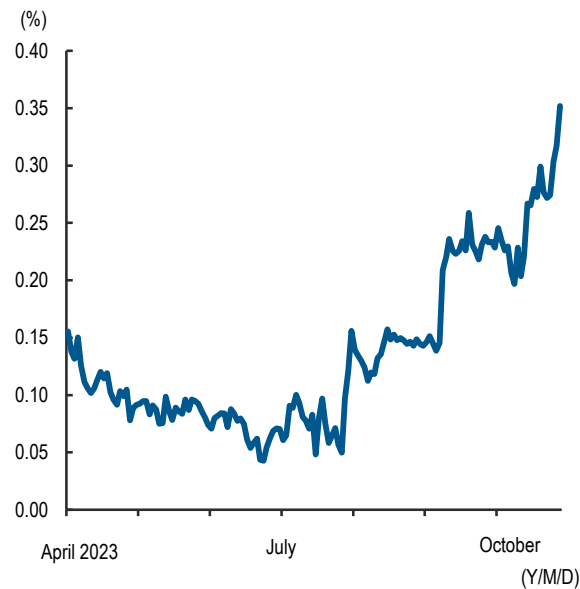
Generally speaking, when short-term interest rates rise, floating mortgage rates also go up. This will not only deflate housing investment, but also increase the burden of repayments for households that have borrowed at floating rates. Mortgage contracts in Japan often feature clauses that mitigate sharp changes in rates. These include the "five-year rule" (where repayment amounts are only reviewed every five years) and the "125% rule" (where increases in repayment amounts are capped at

25%). These clauses prevent rapid increases in the repayment burden even as interest rates climb. However, because the clauses increase the future repayment burden, consumption could be curtailed over the medium to long term.

According to estimates, the increased repayment burden of a 2% rise in floating interest rates will depress consumption in the economy as a whole by 0.5% over the medium to long term. The extent of this suppressive effect will be 2.4 times greater than it was 20 years ago. This is due to the proliferation of floating rate mortgages. The outstanding balance of floating rate mortgages has risen to 130 trillion yen, 2.6 times the balance two decades ago.

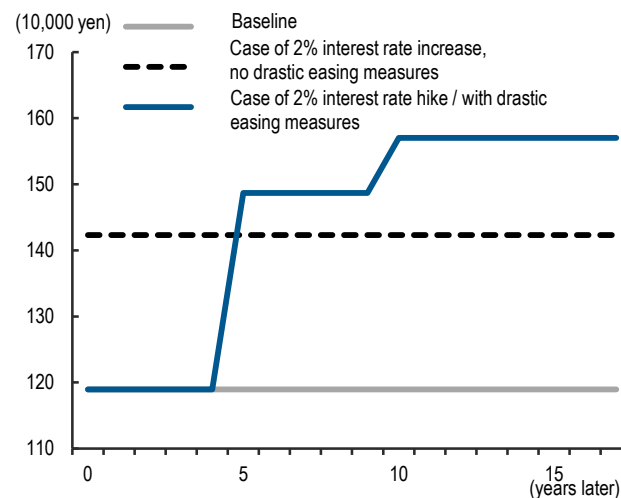
Competition among financial institutions intensified amid the prolonged low interest rate environment, and mortgage tax reduction measures were introduced one after another, which caused the balance of mortgages to rise. And with floating interest rates continuously lower than fixed rates, many borrowers opted for floating rate mortgages to lighten their interest payment burden.

Figure 8-1 Japanese Yen OIS Rate  
<1 month forward>



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

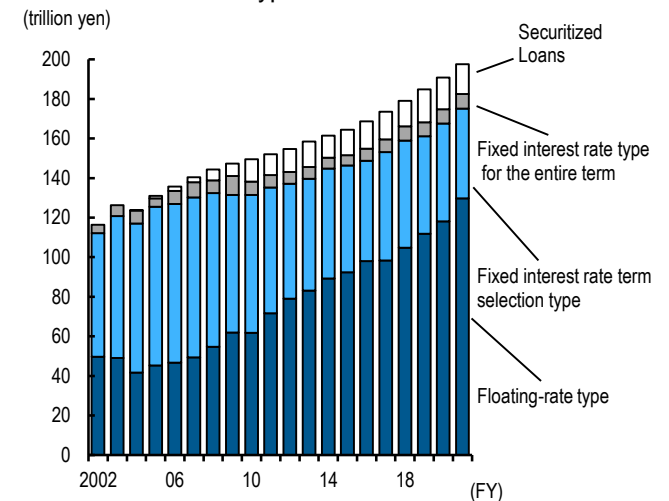
Figure 8-2 Annual Mortgage Repayment



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

Note: In the case with drastic easing measures, the "5-year rule" and "125% rule" are applied, and the repayment amount is reviewed after 5 years. The mortgage balance is set to the average balance of mortgage borrowing households (20.42 million yen) and the remaining term is 18 years. The baseline interest rate is 0.5%.

Figure 8-3 Mortgage Loan Balance by Interest Rate Type



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

Note: Loans from private financial institutions.

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## Japan economic forecast: FY23: +2.0%, FY24: +1.2%

### ◆ The growth rate for FY2023 will be +2.0%

Looking ahead, Japan's economy is expected to continue to slowly recover, driven by domestic demand. With rebounded demand providing much of the impetus, personal consumption should continue its recovery, especially for food/beverage service and other services. And even after this rebounded demand peters out, personal consumption is expected to be supported by an improved income environment. Wage growth rates look set to increase against the backdrop of severe labor shortages, and real wages should stop falling next year.

Capital investment is expected to rise, with the execution of postponed investments the main factor. Furthermore, investment demand for software and information devices is brisk, and digital investment for labor-saving and data-related applications will drive future capital investment. The real economic growth rate is expected to be +2.0% in FY2023 and +1.2% in FY2024, remaining above the potential growth rate, which is in the mid-0% range.

### ◆ Rising oil prices pose risks for the near term

However, there is a risk of an economic downswing if oil prices go even higher. Prolonged imported inflation has caused real wages to stagnate and the recovery in personal consumption to falter. It is feared that a decline in corporate earnings could reduce the appetite for capital investment.

### ◆ Core inflation remains above 3%

In September, core inflation came in at 2.8%, down from the previous month. Reflection in the core CPI of falling resource prices this summer was delayed due to the effect of the government's fuel cost adjustment system (which adjusts electricity charges according to import prices of raw materials). As a result, electricity and gas bills fell by a larger margin and the pace of rises in durable goods prices slowed. However, the speed of price increases for items, especially services, that are closely linked to wages is getting faster, and moves to pass on increased labor costs to prices are gradually becoming more evident.

Looking ahead, core inflation should remain at around 3% as the government's reduction/termination of its price hike countermeasures boosts energy prices, though growth in the Bank of Japan's version of the core CPI (composite excluding fresh food and energy) is expected to slow. Although inflationary pressures from rising wages will persist, price hikes caused by high raw material prices look set to subside. However, there is a risk of a fresh intensification of imported inflationary pressures if there is a continuation of rising oil prices and a falling yen.

Figure 9 Projections for GDP Growth and Main Indicators of Japan ( as of November 10, 2023 )

( %, changes from the previous fiscal year )

	CY2023				CY2024				CY2025	FY2022	FY2023	FY2024
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	
	(Actual)		(Projection)									
Real GDP	3.2	4.8	▲ 0.3	1.8	1.5	1.0	1.0	0.9	0.9	1.4	2.0	1.2
Private Consumption Expenditure	2.4	▲ 2.5	0.2	2.0	1.5	1.2	1.2	1.0	1.0	2.5	0.3	1.2
Housing Investment	2.7	8.1	▲ 5.4	0.1	0.0	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 3.0	1.9	▲ 0.4
Business Fixed Investment	6.6	▲ 4.0	1.1	3.8	3.6	2.8	2.4	2.2	2.2	3.1	1.1	2.8
Private Inventories (percentage points contribution)	( 1.4)	(▲ 0.6)	( 0.1)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.2)	(▲ 0.1)	( 0.0)
Government Consumption Expenditure	0.3	0.1	0.4	0.1	0.1	0.1	0.0	0.0	0.0	0.7	0.2	0.1
Public Investment	5.8	1.0	▲ 0.4	1.4	1.2	1.2	1.0	0.8	0.8	▲ 3.1	1.8	1.0
Net Exports (percentage points contribution)	(▲ 1.0)	( 7.1)	(▲ 0.6)	( 0.3)	( 0.2)	(▲ 0.0)	(▲ 0.0)	( 0.0)	( 0.0)	(▲ 0.6)	( 1.5)	( 0.0)
Exports of Goods and Services	▲ 14.4	12.9	10.5	1.6	1.8	1.7	1.7	2.0	2.2	4.5	3.7	2.3
Imports of Goods and Services	▲ 8.7	▲ 16.5	12.7	0.2	0.8	1.8	1.8	1.9	2.1	7.2	▲ 2.6	2.1

	(% changes from the same quarter of the previous year)									(% changes from the previous fiscal year)		
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	FY2022	FY2023	FY2024
Nominal GDP	4.0	5.1	6.8	5.8	4.9	2.7	3.1	2.8	2.3	2.0	5.6	2.7
GDP deflator	2.0	3.5	4.8	3.4	2.7	1.6	1.6	1.6	1.2	0.7	3.6	1.5
Consumer Price Index (excluding fresh food)	3.5	3.2	3.0	2.8	3.0	3.0	3.3	2.7	2.3	3.0	3.0	2.8
Unemployment Rate (%)	2.6	2.6	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.6	2.6	2.3
Exchange Rates (JY/US\$)	132	138	145	148	147	144	142	140	138	135	145	141
Import Price of Crude Oil (US\$/barrel)	87	83	83	94	93	90	86	83	82	103	88	85

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.