Monthly Report of Prospects for Japan's Economy

January 2024

Macro Economic Research Center
Economics Department

The Japan Research Institute, Limited

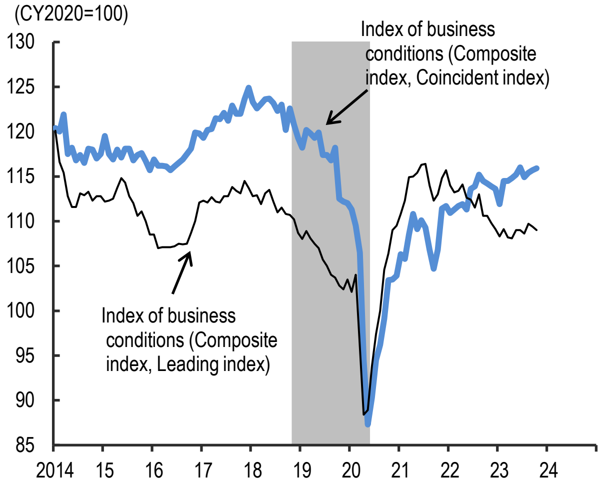
https://www.jri.co.jp/english/periodical/

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

The General Situation – The economy is gradually recovering, though activity has slowed in some areas

Figure 1-1 Economic Activity

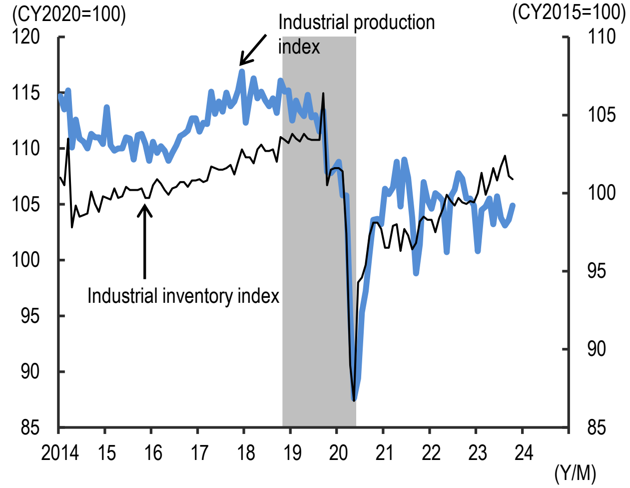
Coincident economic indicators are improving.
Leading indicators are unchanged.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

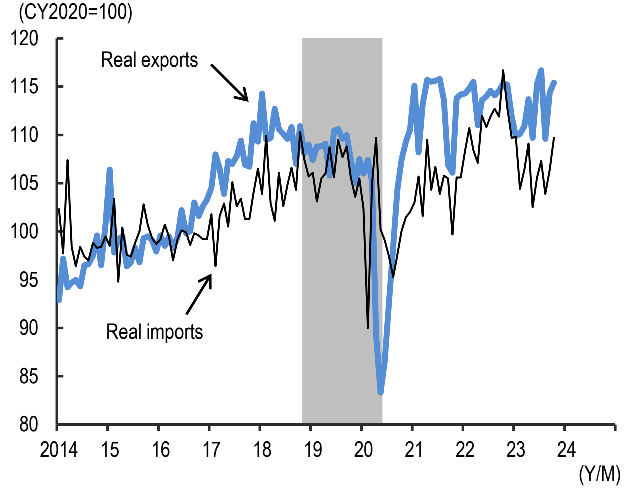
Industrial production is fluctuating.
Economic activity in the service sector is on the recovery track.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

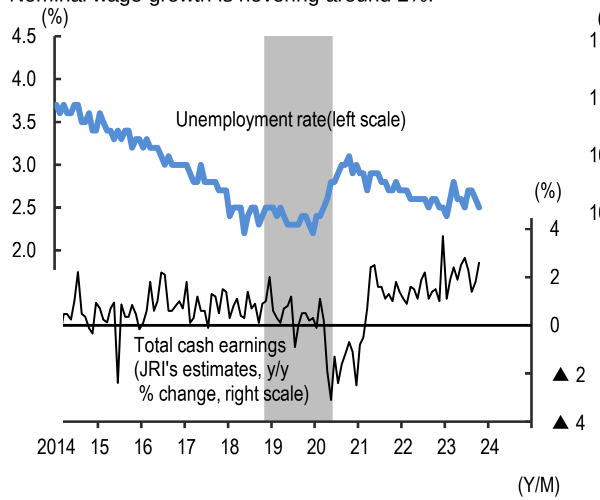
Exports, particularly of automobiles, are increasing.
Imports of electrical equipment have been rising recentry.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

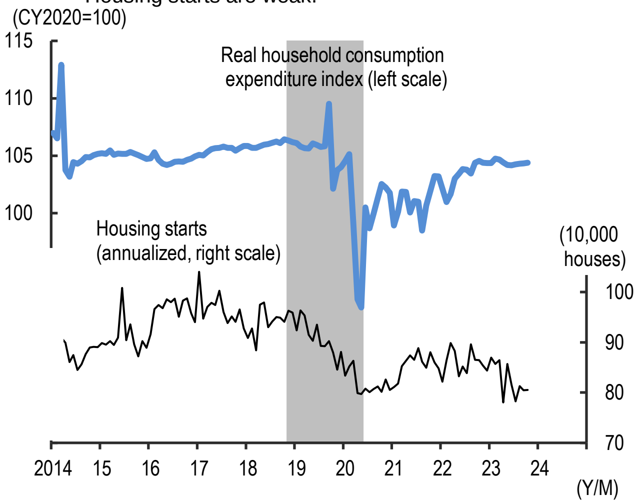
The unemployment rate is hovering in the mid-2% range.
Nominal wage growth is hovering around 2%.



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

Figure 1-5 The Household Sector

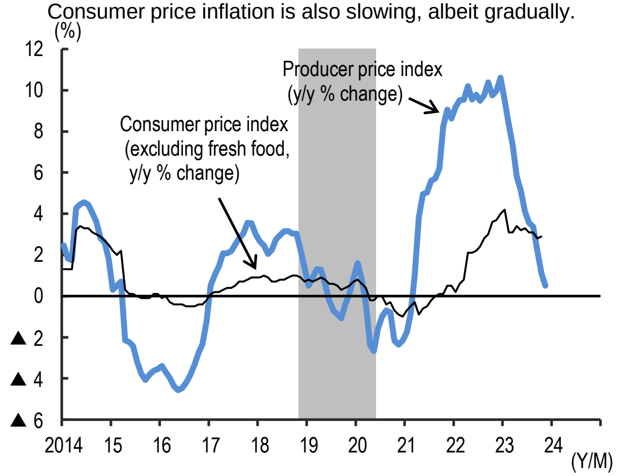
Consumption remains on the recovery track.
Housing starts are weak.



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 is also slowing, albeit gradually.



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

＊The shaded area indicates the recession phase.

Glowth in July-September was negative, but has been positive since October

◆ Declining domestic demand is pushing down the growth rate

Real GDP in the July-September quarter shrank at an annualized rate of 2.9% quarter over quarter (QoQ), the first negative growth in three quarters. A sharp decline in inventory investment pushed the growth rate down by 1.9 percentage points. Foreign demand made a negative contribution due to increased service imports, while personal consumption and capital investment dropped for the second consecutive quarter. In personal consumption, consumption of durable goods, especially home appliances, fell as consumers cut back on their spending in the face of rising prices. As for capital investment, expenditures on such items as production machinery declined against a backdrop of weak global demand for goods.

◆ Manufacturing activity shows signs of picking up

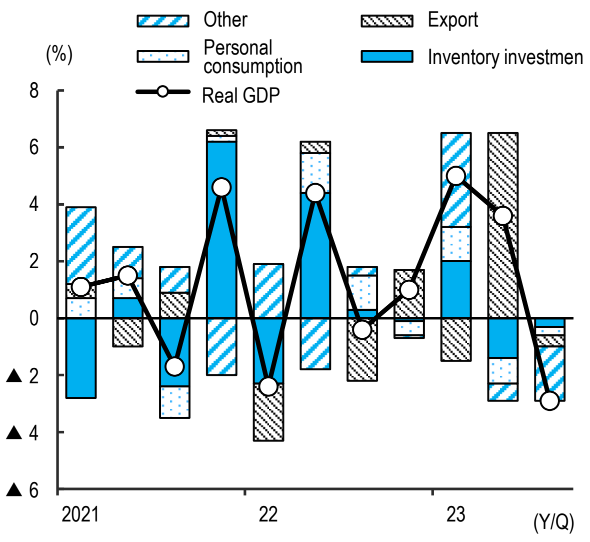
Production activity recovered in October. In October, the Industrial Production Index increased for the second straight month, rising 1.3% from the previous month. Production was up in a wide range of sectors, including automobiles, where sales were strong, and electronic components/devices, where output rebounded as inventories dwindled.

Near-future production plans indicate a decrease in output in November (-0.3% month over month (MoM)) and an increase in December (+3.2% MoM). With the global capital investment cycle bottoming out, activity in Japan's manufacturing sector is expected to pick up, particularly in capital goods-related industries.

◆ Personal consumption has increased recently

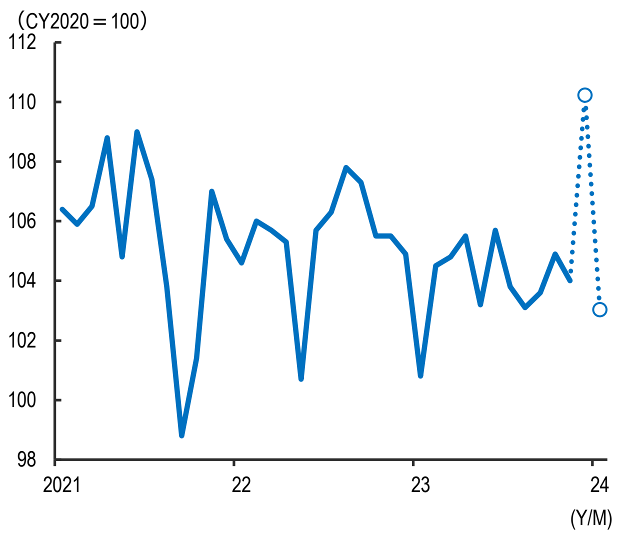
Consumption also recovered in October. In October, the Tertiary Industry Activity Index rose for the first time in two months, increasing 0.6% from the previous month. Breaking this down, consumption of services, which include lodging and food/beverage service, increased, as did that of durable goods, especially automobiles.

Figure 2-1 Real GDP Growth Rate



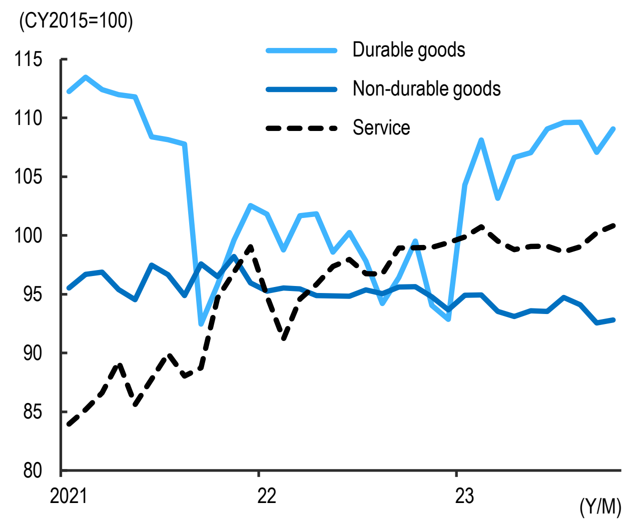
Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Figure 2-2 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 (December and January).

Figure 2-3 Consumption Activity Index



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

Goods exports are showing signs of bottoming out, and inbound tourism demand

◆ Goods exports are increasing

In October, real exports increased from the previous month. By product category, exports of transportation machinery rose sharply as supply constraints eased, while exports of capital goods and semiconductor-related goods also rebounded.

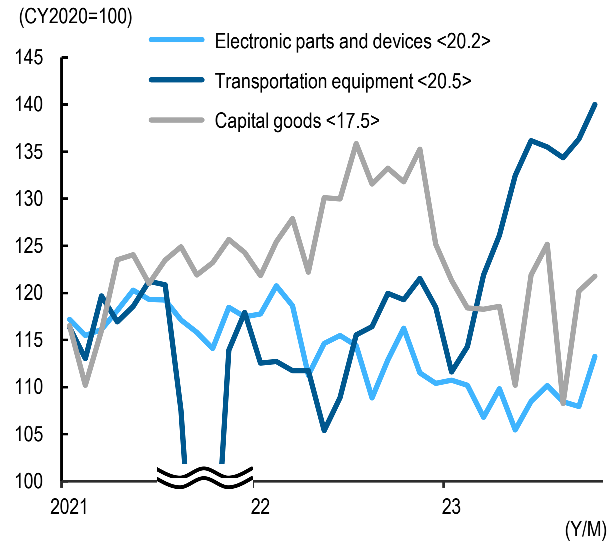
Looking ahead, goods exports are expected to start picking up. Although the slowdown in overseas economies will continue to weigh on exports, the global semiconductor cycle and capital investment cycle are bottoming out. Demand is therefore projected to increase in segments such as production equipment and semiconductor manufacturing equipment. Exports of electronic components/devices and capital goods are expected to start rising gradually, driven by the global proliferation of electric vehicles and higher demand associated with generative AI.

◆ The number of foreign visitors to Japan has topped the pre-COVID level

The number of foreign visitors to Japan in October rebounded to 2.52 million, which is 0.8% above the October 2019 level. Although tourists from China have been slow to return, with the number reaching only about 40% of the pre-COVID level, visitors from East Asian countries and regions other than China, such as South Korea and Taiwan, and from the U.S. have increased.

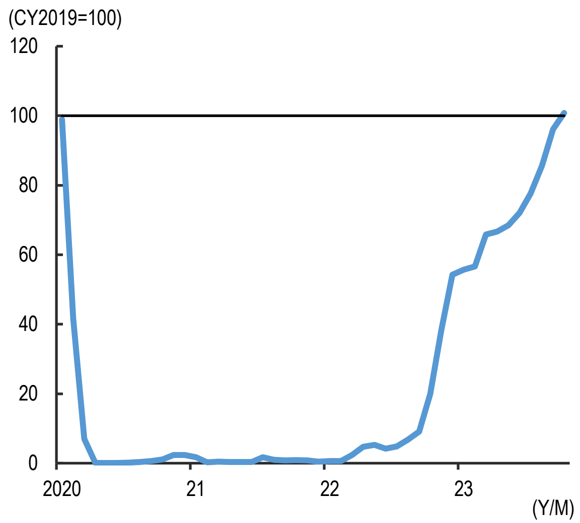
Going forward, the pace of the recovery in inbound tourism demand is expected to slow. There is plenty of room of recovery in the number of visitors from China, and Chinese travelers to Japan should gradually increase in number, but a full-scale recovery looks likely to take time. The return of Chinese visitors not just to Japan but also to other Asian countries has been delayed due to such factors as the sluggish Chinese economy.

Figure 3-1 Recovery of Chinese Visitors in Asia



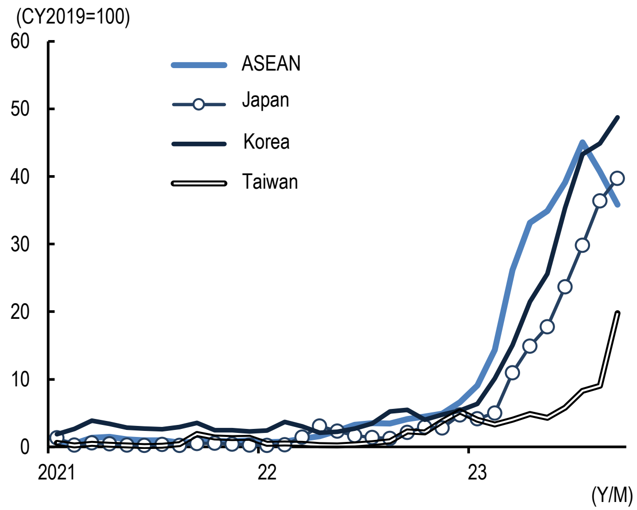
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.
Note: <>Figures in parentheses represent the share of total nominal exports in 2022.

Figure 3-2 Number of Foreign Visitors to Japan



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

Figure 3-3 Recovery of Chinese Visitors in Asia



Source: The Japan Research Institute, Ltd. based on data of The CEIC Date.
Note: ASEAN is the sum of Indonesia, the Philippines, Thailand, Singapore, and Vietnam.

Capital investment will increase thanks to strong corporate earnings

◆ Corporate earnings remain at high levels

According to the Financial Statements Statistics of Corporations, ordinary profit for the July-September quarter increased 0.8% QoQ across all industries, rising for the third consecutive quarter. Ordinary profit as a percentage of net sales remained over 7%, its highest level ever. While higher labor costs served to depress earnings, revenues climbed as companies increasingly passed on higher costs to customers. In addition, variable costs were kept in check thanks to a lull in the upward trend of raw material prices, and this was another factor behind the rise in ordinary profits.

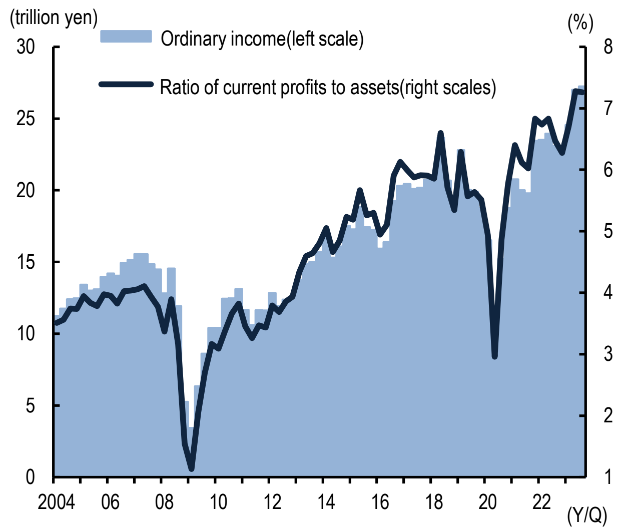
Even after October-December, corporate earnings are expected to remain high overall. The inflationary pressure on costs is likely to subside due to the halt to the yen's depreciation and the pause in resource price rises. Corporate earnings are expected to remain strong as the pick-up in domestic and foreign demand will support sales growth.

◆ Software is driving capital investment

According to the Financial Statements Statistics of Corporations, capital investment in July-September was up 1.4% QoQ, rising for the first time in two quarters. In terms of categories, software investment spiked by 10.0% QoQ, while investment in other categories was weak, edging up just 0.3%. While investment in machinery, which is closely linked with foreign demand, slackened due to the slowdowns in overseas economies, investment in software, which is less sensitive to short-term economic trends, held firm.

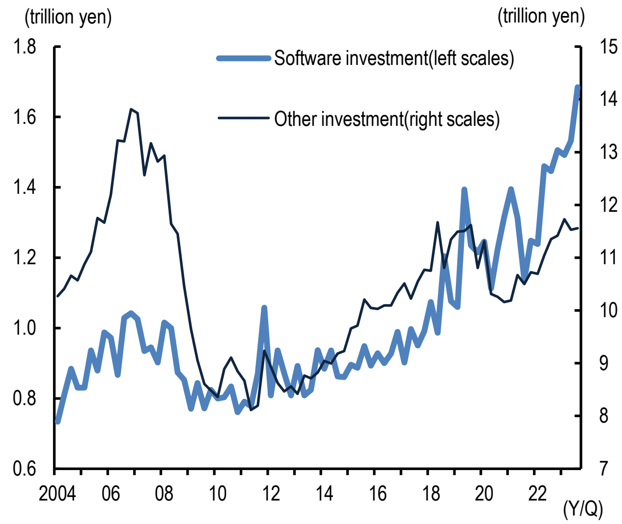
Capital investment is also expected to increase going forward, funded by the high levels of corporate earnings. According to a survey of projections for the October-December Financial Statements Statistics of Corporations, companies are maintaining a proactive stance toward capital investment. In addition, the current downward phase of the global silicon cycle and capital investment cycle is slowly bottoming out, and

Figure 4-1 Ordinary Income and Ratio of Ordinary Income to Net Sales <seasonally adjusted>



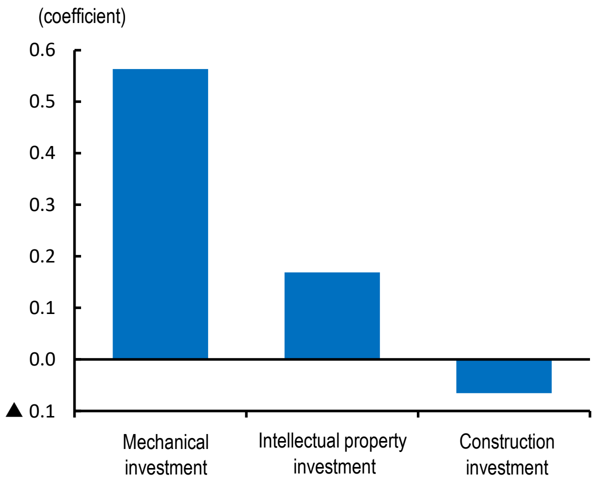
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note: All sizes, all industries.(Excluding finance and insurance)

Figure 4-2 Capital Investment by Corporations <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note: All sizes, all industries.(Excluding finance and insurance)

Figure 4-3 Correlation Coefficient between Export and Fixed Capital Form



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.
Note: Real terms, year-on-year.
The period is January-March 1995 to April-June 2023.

The employment/income situation is gradually improving

◆ The number of workers is rising gradually

The unemployment rate for October was 2.5%, falling for the second month in succession. The number of involuntary unemployed people has been decreasing recently, and is now down to its pre-COVID level. The number of workers is still rising. By industry, the higher headcounts are being driven by sectors where demand is recovering, such as lodging and food/beverage service as well as information and communications.

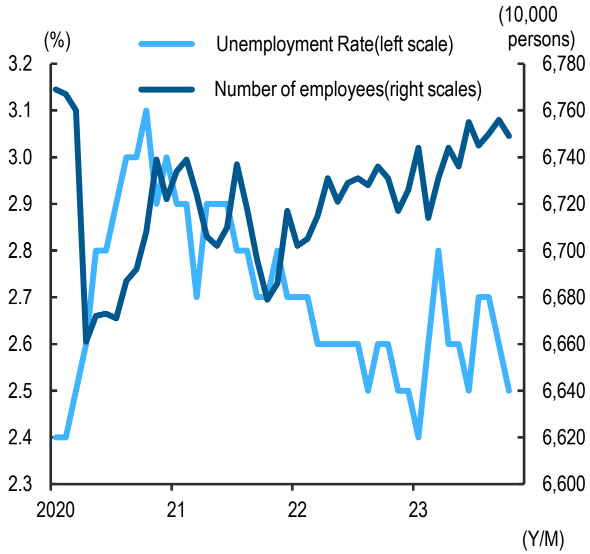
The job market is expected to become increasingly tight going forward. Demand for labor will increase as economic activity recovers, but there is limited room for expansion in the labor supply. Regarding the size of the labor force, the number of elderly workers has already peaked, and growth in female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

◆ The rate of nominal wage growth is rising

In October, basic salaries of regular employees increased by 1.7% YoY, and the hourly pay of part-time workers also climbed 3.7% 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 2.3% YoY for the 19th consecutive month of negative growth.

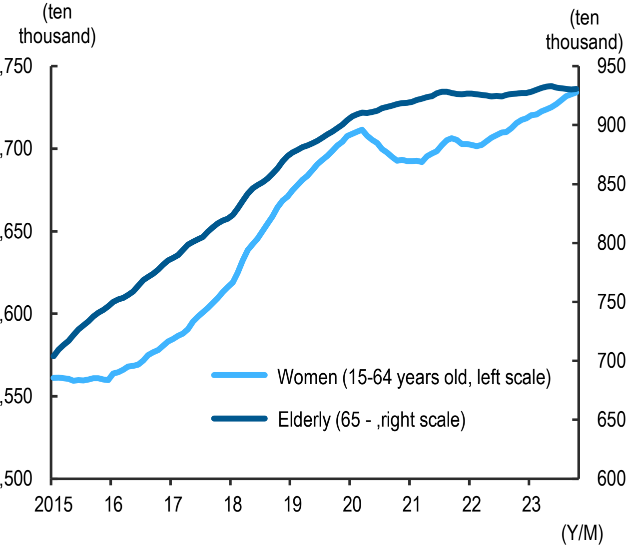
Going forward, wage growth rates are expected to increase. Against the backdrop of strong corporate earnings, rising prices, and intensifying labor shortages, the wage growth rate (including regular salary increases) is projected to be around 3.8% in the 2024 "shunto", higher than it was in 2023. Wages are also expected to go up for part-time and other non-regular employees as minimum wages rise and the labor market tightens.

Figure 5-1 Unemployment Rate and Number of Employees
<seasonally adjusted>



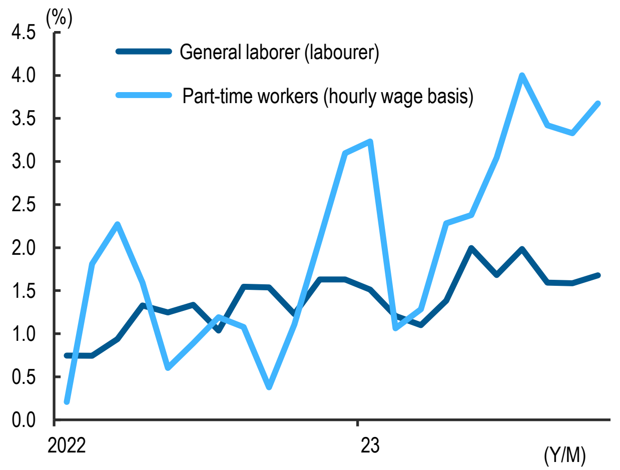
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

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 Prescribed Salary
<year-on-year>



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.

Topic: High-income households are becoming increasingly thrifty as prices rise

◆ Consumption by high-income households has plummeted

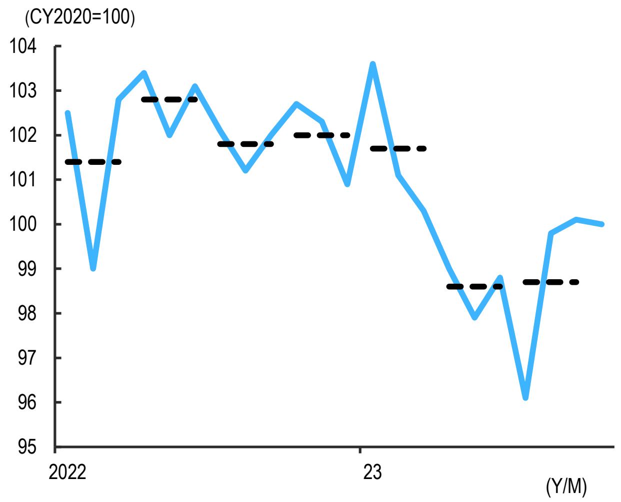
Households are curbing their consumption as they grapple with reduced purchasing power due to soaring prices. Real consumption (by households of two or more persons) in the Family Income and Expenditure Survey was weak during the summer. Consumption by high-income households is substantially lower than it was before the COVID pandemic.

◆ Discretionary spending is being curtailed

As a background factor, it is worth pointing out that discretionary spending accounts for a high percentage of the consumption expenditures of high-income households. Since it is difficult for them to reduce the volume of basic necessities they buy, households keep their expenditures in check by cutting back on purchases of luxury goods, for example. The share of discretionary spending in consumption expenditure (in 2022) was 44.6% for high-income households, which is higher than that for low- and middle-income households, giving the former considerable scope to adjust their consumption expenditure.

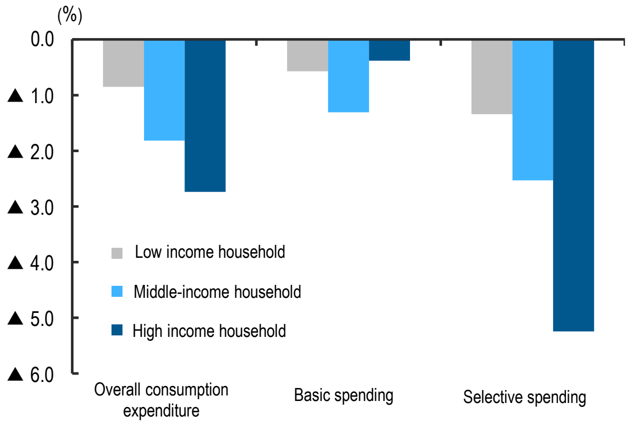
Reasons for making replacement purchases of durable goods may also be a factor behind differences in consumption patterns between classes of consumers. Looking at the reasons given for replacing durables such as home appliances and automobiles, high-income households often cite reasons other than the previous product no longer working, so it is easier for them to adjust the timing of purchases. High-income households may therefore be postponing purchases of durable goods during this inflationary spell.

Figure 6-1 Real Consumption



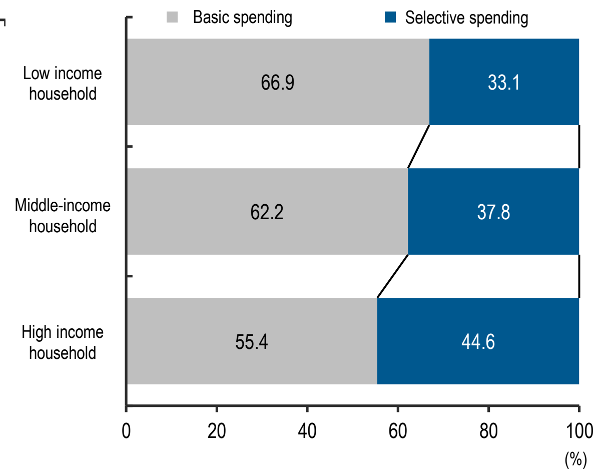
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note: Households of two or more persons.
Dashed lines are quarterly averages.

Figure 6-2 Real Consumption by Income Group <in the first of FY2023>



Source: The Japan Research Institute, Ltd. based on data of The Misnistry of Internal Affairs and Communications.
Note1: Households with two or more workers.Comparison of the same period from 2016 to 2019.
Note2: Low income households are in quintiles Ⅰ and Ⅱ, middle-income households are in quintiles Ⅲ, high income households are in quintiles Ⅳ and Ⅴ.

Figure 6-3 Breakdown of Consumption Expenditure in 2022



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

Japan economic forecast: FY23: +1.6%, FY24: +1.2%, FY25: +1.0%

◆ Strong corporate earnings will serve as a launchpad

Looking ahead, Japan's economy is expected to slowly recover, driven by domestic demand. Bumper corporate earnings will likely lead to a proactive stance on spending among firms, characterized by wage hikes that outpace inflation and an expansion in future-oriented capital investment.

Personal consumption is expected to see a moderate recovery as households spend the savings they built up during the COVID pandemic and benefit from an improved employment and income environment. While there is limited room for a further rebound in services consumption, durable goods, prices of which are now rising at a much slower clip, will drive the recovery.

Capital investment is projected to increase thanks to strong corporate earnings. In addition to stepping up digital investment for labor-saving amid increasingly severe personnel shortages, companies are expected to accelerate moves to relocate production back to Japan in the face of mounting geopolitical risks and the continued weakness of the yen.

◆ The growth rate for FY2023 will be +1.6%

The real growth rate is projected to be +1.6% in FY2023, +1.2% in FY2024, and +1.0% in FY2025. Although the potential growth rate is currently estimated to be around 0.5%, it should rise to around 1% by 2025 as labor productivity improves.

◆ Core Policy factors are pushing up energy prices

In October, core inflation accelerated from the previous month to 2.9%. Government subsidies for electricity and gas bills have been cut in half, which has dampened the effect of falling energy prices. The pace of increase of the Bank of Japan's (BOJ's) version of the core CPI (composite excluding fresh food and energy) slowed to 4.0%. Imported inflation is beginning to subside, and the speed of rises in prices of semi-durable goods and non-durable goods has passed its peak. However, prices of services are still soaring. Inflationary pressure stemming from wage increases is intensifying.

Looking ahead, the BOJ's version of the core CPI is expected to rise at a slower pace, though core inflation looks set to remain above 2% as the government's reduction/termination of its measures to combat soaring energy prices pushes up utility bills. While moves to raise prices due to high raw material costs should abate, moves to pass on higher labor costs to prices are expected to become more widespread as wages rise faster.

Figure 7 Projections for GDP Growth and Main Indicators of Japan (as of December 20, 2023)

(%, changes from the previous fiscal year)

	CY2023		CY2024				CY2025			FY2023	FY2024	FY2025
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9			
	(Actual)	(Projection)								(Projection)		
Real GDP	▲ 2.9	1.7	1.6	1.6	0.9	1.1	1.0	1.0	1.0	1.6	1.2	1.0
Private Consumption Expenditure	▲ 0.6	2.0	1.5	1.8	0.6	1.0	0.9	0.8	0.8	0.3	1.2	0.8
Housing Investment	▲ 2.1	0.1	0.0	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 0.2	▲ 0.3	2.0	▲ 0.2	▲ 0.2
Business Fixed Investment	▲ 1.8	2.8	3.0	3.5	3.1	2.4	1.8	2.0	2.2	0.2	2.7	2.1
Private Inventories (percentage points contribution)	(▲ 1.9)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.2)	(▲ 0.1)	(▲ 0.0)
Government Consumption Expenditure	1.3	0.3	0.2	0.1	0.0	0.0	0.0	0.2	0.2	0.7	0.2	0.1
Public Investment	▲ 3.1	2.2	1.2	1.2	1.0	0.8	0.8	0.8	0.4	2.8	1.0	0.6
Net Exports (percentage points contribution)	(▲ 0.4)	(0.0)	(0.3)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)	(1.4)	(0.1)	(0.2)
Exports of Goods and Services	1.5	4.6	3.1	1.7	1.7	2.2	2.6	2.8	3.0	3.4	2.4	2.8
Imports of Goods and Services	3.2	4.3	1.6	1.2	1.4	1.4	1.6	2.0	2.1	▲ 2.5	1.8	1.9
						(% changes from the same quarter of the previous year)				(% changes from the previous fiscal year)		
Nominal GDP	6.9	6.0	5.0	2.8	3.7	3.0	2.6	2.2	2.1	6.0	3.0	2.1
GDP deflator	5.3	4.3	3.8	2.3	2.1	1.7	1.3	1.1	1.1	4.3	1.8	1.0
Consumer Price Index (excluding fresh food)	3.0	2.6	2.8	2.4	2.5	2.1	1.9	1.9	1.5	2.9	2.2	1.6
Unemployment Rate (%)	2.6	2.5	2.5	2.5	2.4	2.4	2.3	2.3	2.3	2.6	2.4	2.3
Exchange Rates (JY/US$)	145	148	145	142	140	138	136	134	132	144	139	131
Import Price of Crude Oil (US$/barrel)	83	91	81	80	81	77	75	74	74	84	78	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.