

Monthly Report of Prospects for Japan's Economy

March 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 February 2024 issue of the original Japanese version.

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The General Situation – The economy recovered moderately, despite stalls in some areas

Figure 1-1 Economic Activity

The coincident index of business conditions showed improvement. The leading index remained unchanged.

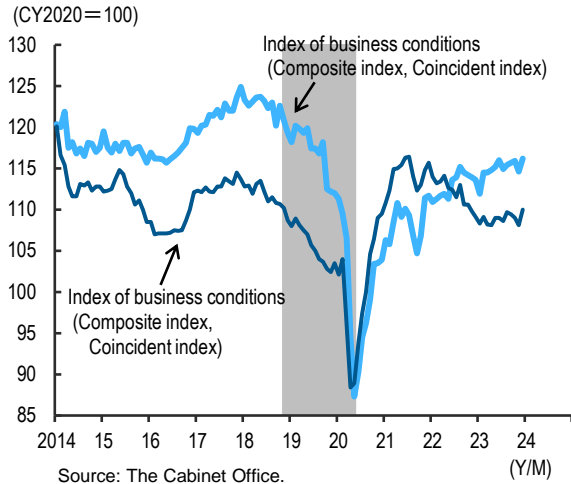


Figure 1-2 The Corporate Sector

Industrial production moved back and forth. Economic activity in the service sector has been sluggish since last fall.

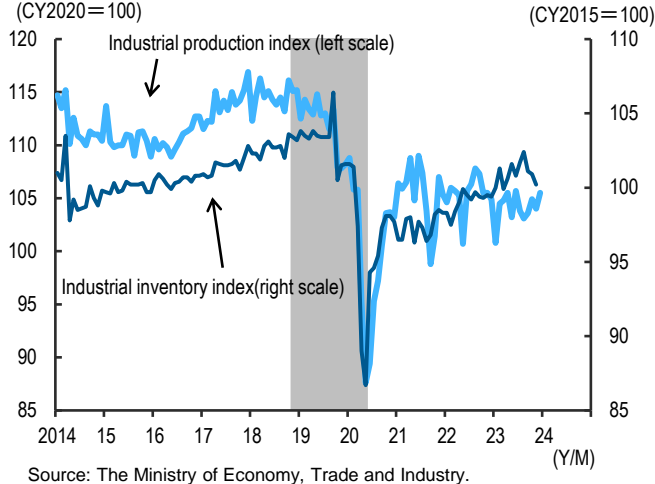


Figure 1-3 Overseas Demand

Exports increased mainly in automobile-related industries. Imports remained unchanged with some fluctuations.

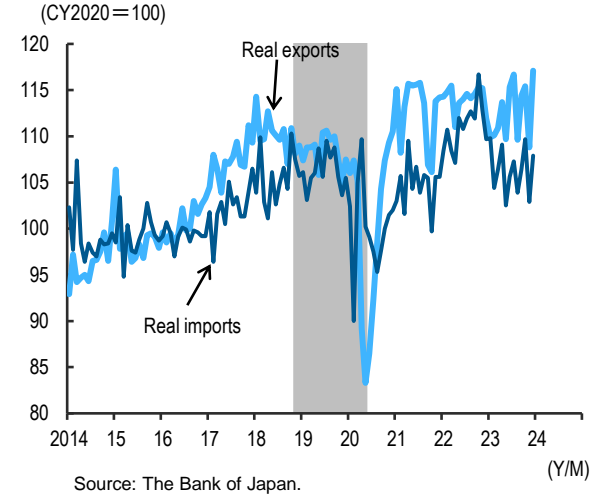
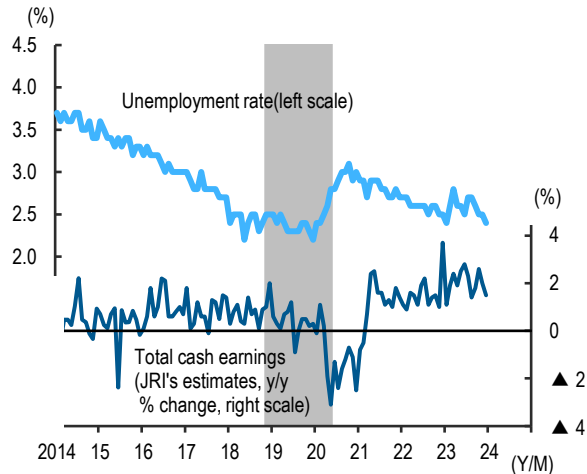


Figure 1-4 Employment and Income

The unemployment rate fell to the mid-2% range. Nominal wage growth remained around 2%.



* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

Consumption remained on a recovery track. Housing starts showed weak developments.

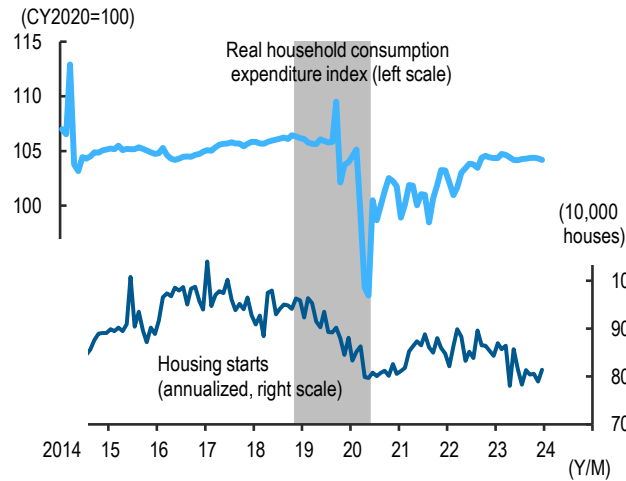
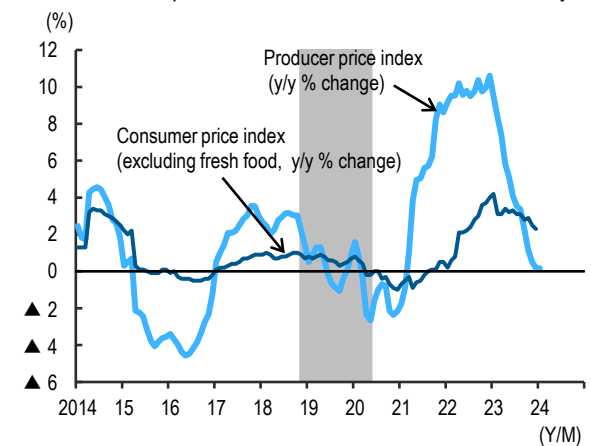


Figure 1-6 Prices

Corporate price inflation declined sharply to nearly 0%. Consumer price inflation also decelerated moderately.



GDP contracted for the second consecutive quarter in October-December 2023

◆ Domestic demand lacked strength

The real GDP in the October-December quarter of 2023 contracted at an annualized rate of 0.4% (0.1% quarter-on-quarter), marking the second consecutive quarter of negative growth. Foreign demand made a positive contribution, driven by a significant increase in exports of services such as fees for intellectual property rights and a recovery in exports of goods, mainly transportation machinery, but the decline of domestic demand offset the increase. In personal consumption, semi-durable goods such as clothing declined due to the warm winter, and the recovery in service consumption slowed, too, in response to higher prices. Housing investment also contracted amid soaring construction costs triggered by higher material prices and labor costs.

◆ Manufacturing moved back and forth

The industrial production index for December 2023 increased for the first time in two months, rising 1.4% from the previous month. Production increased across

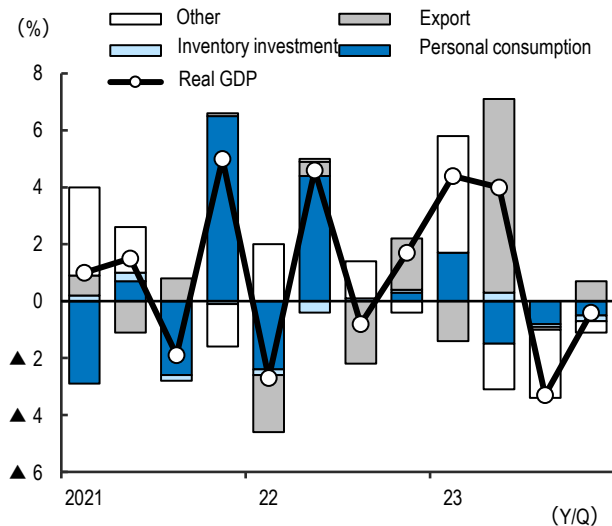
various industries, including general-purpose and commercial machinery production, due to increased orders, mainly for factories and logistics facilities.

The future production plan anticipates a 6.2% month-on-month decrease in January 2024, followed by an expected 2.2% month-on-month increase in February 2024. The temporary suspension of production and shipments by certain automakers, and the impact of the Noto Peninsula earthquake are likely to exert downward pressure on production.

◆ Effects of the earthquake disaster depressed business confidence

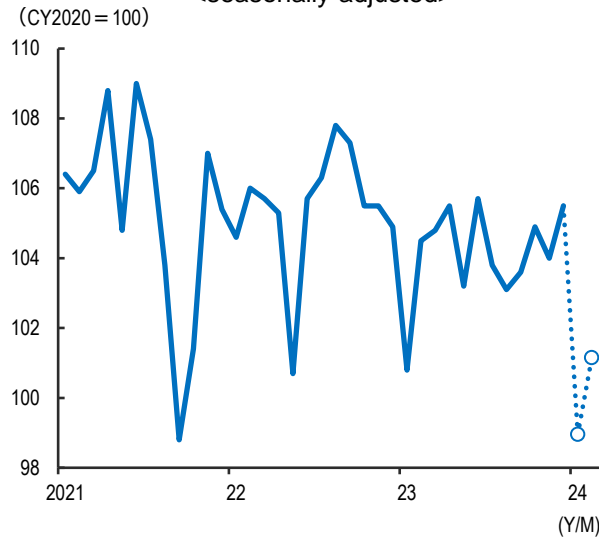
The DI for current business conditions in the January Economy Watchers Survey declined for the first time in four months, falling 1.6 points from the previous month. By region, the Hokuriku region saw a significant decline. Concerns are mounting over the decrease in tourist numbers in the aftermath of the Noto Peninsula earthquake, coupled with the increasing inclination towards self-restraint in consumption.

Figure 2-1 Real GDP Growth Rate



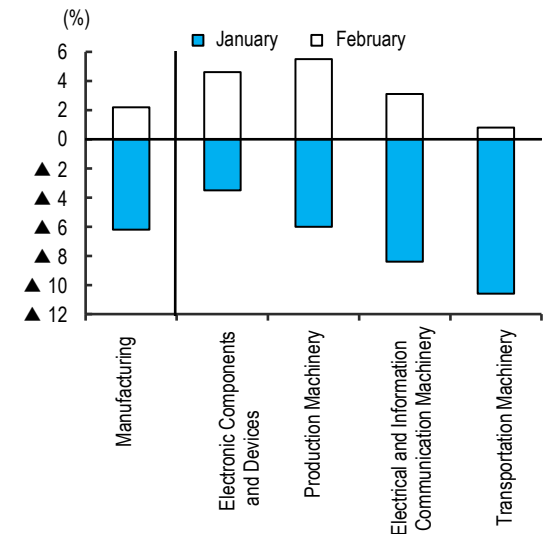
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.
Note: Annualized rate for the previous period.

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: Dotted lines are postponed based on the forecast index of manufacturing production (January and February).

Figure 2-3 Production Plan by Industry <MoM>



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

Monthly Report of Prospects for Japan's Economy March 2024
The Japan Research Institute, Limited

Exports are on the rise, but concerns persist about the Chinese economy

◆ Goods exports are picking up

Real exports increased moderately. By product, transportation machinery, for which recovery production began in high gear as component shortages subsided, maintained a high level of exports, while long-constrained capital goods exports also saw a rebound.

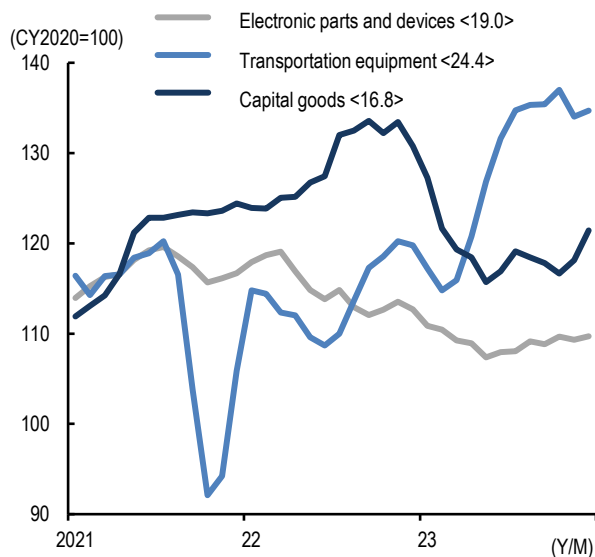
The outlook for exports in the January-March quarter is likely to see a temporary downturn, affected by the suspension of production and shipments by certain automakers and the Noto Peninsula earthquake. Subsequently, exports will return to an upward trend primarily in electronic components and capital goods, supported by the cyclical pickup in demand for goods. Demand for semiconductors is hitting the bottom worldwide, and global companies have improved their long-restrained capital investment. As for machinery manufacturers, overseas orders turned to an increase.

◆ China's economic downturn poses downside risks to Japanese exports

However, there is a risk that a further slowdown in the Chinese economy could put downward pressure on Japanese exports. China's economic recovery remains slow, mainly due to the lingering adjustment of the real estate market. Japan's exports to China peaked at the beginning of 2021, followed by a continuing downward trend. Even now, China's manufacturing PMI remains below the critical 50 level.

The potential deceleration in the Chinese economy could intensify the downward pressure on Japan's exports, particularly through economic downturns in neighboring countries. Countries such as Taiwan and Singapore, with their high dependency on exports to China (on a value-added basis), are particularly susceptible to the direct impact of declining demand from China. The risk of intra-Asia trade declines to cascade into Japan's exports through supply chains bears close watching.

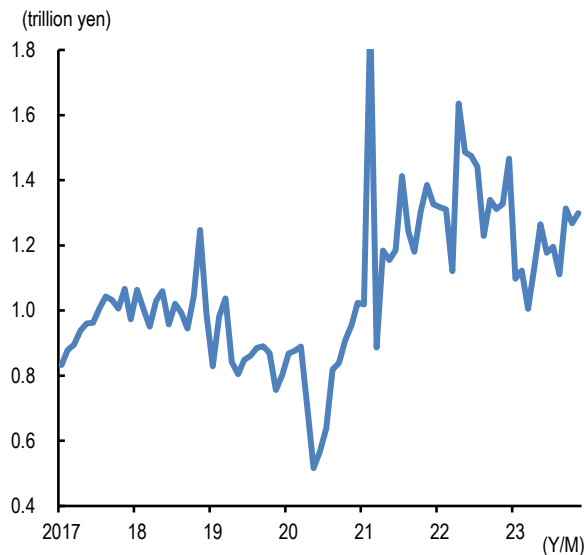
Figure 3-1 Real Export by Area <seasonally adjusted>



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

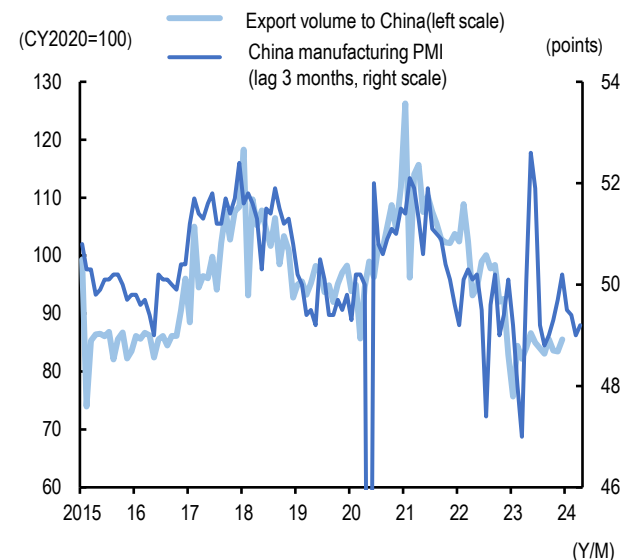
Note: <>Figures in parentheses represent the share of total nominal exports in 2023.Backward 3-month moving average.

Figure 3-2 Machinery Orders <external demand>



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

Figure 3-3 China Manufacturing PMI and Export Volume to China



Source: The Japan Research Institute, Ltd. based on data of The National Bureau of Statistics of China, The Ministry of Finance.

Monthly Report of Prospects for Japan's Economy March 2024
The Japan Research Institute, Limited

Household income environment improved moderately

◆ Labor unions demand higher wages than last year

In December 2023, the scheduled cash earnings of general workers continued to grow moderately by 1.9% year-on-year. Part-time workers' hourly wages maintained high annual growth at 4.0%. However, such growth failed to keep pace with the increase in consumer prices, with real wages falling 3.0% year-on-year for the 21st consecutive month of decline.

Wage growth is poised to accelerate. Fueled by robust corporate earnings, inflation, and a growing awareness of labor shortages, the anticipated wage increase rate (including regular salary increments) after the 2024 the spring wage offensive will be around 3.8%, surpassing last year's rate. Many labor unions are inclined to seek wage increases at a higher level than the previous year.

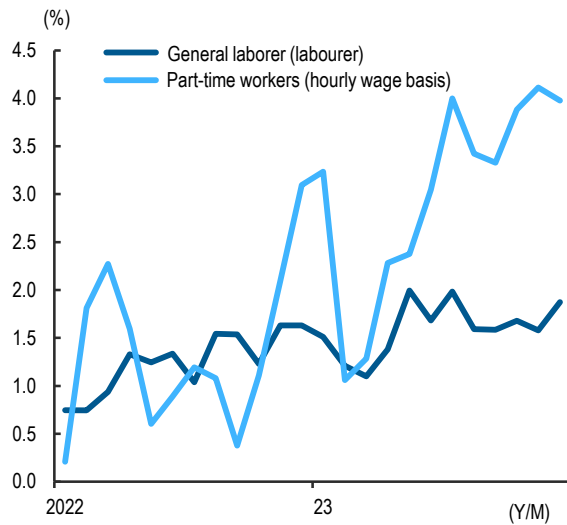
◆ Automobile sales experienced a significant decline

New car sales in January saw a steep 9.2% decrease month-on-month. The suspension of shipments due to irregularities by certain manufacturers significantly impacted the sales of light vehicles. Currently, only a limited number of models are set to resume production and shipments, posing a potential risk to future consumer spending.

◆ Consumer confidence improved

The Consumer Confidence Index for January continued its upward trend, registering a 0.8-point increase compared to the previous month, marking the fourth consecutive monthly rise. On the perception indexes, indicators centered on the buying decisions for durable consumer goods and living conditions rose amid subdued price hikes and expectations for higher wages.

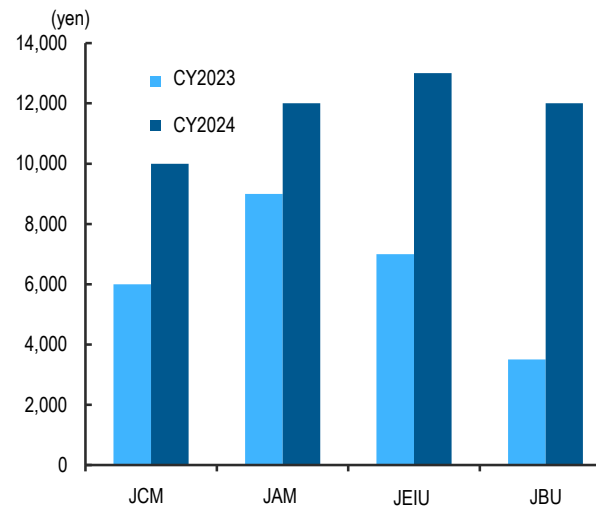
Figure 4-1 Scheduled Cash Earnings <YoY>



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

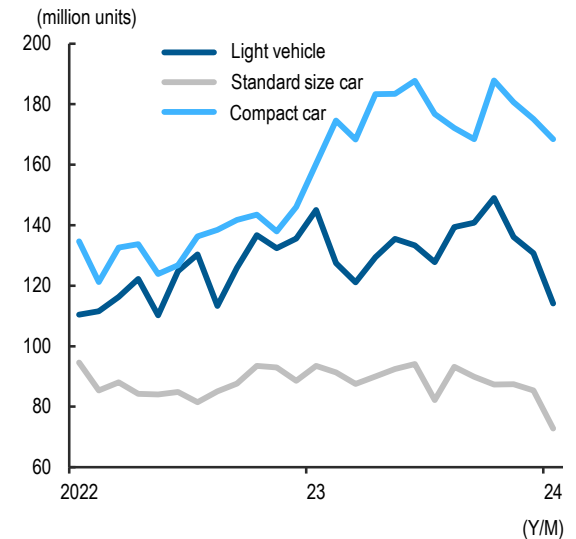
Note: Adjusted for data fault caused by the replacement of surveyed companies.

Figure 4-2 Amount of Base Increase Demanded by Labor Unions



Source: The Japan Research Institute, Ltd. based on data of The Amount of base increase demanded by labor unions.

Figure 4-3 New Vehicle Registrations <annualized, seasonally adjusted>



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

Monthly Report of Prospects for Japan's Economy March 2024
The Japan Research Institute, Limited

Price hikes due to wage increases are spreading to private services

◆ Imported inflationary pressures are easing

Core CPI growth in December 2023 contracted from the previous month to 2.3% year-on-year. Energy prices saw a significant drop, following significant increases in electricity and gas prices in the previous year. Additionally, the rate of price increase in other goods items slowed as imported inflationary pressure eased. Meanwhile, the service items maintained persistent high price growth. Although many public service items maintained stable prices, there was an increase in private service items, rising by approximately 3% compared to the previous year. This upward trend was driven by an expanding practice of passing on wage increases to prices, particularly in private services such as transportation and education-related sectors.

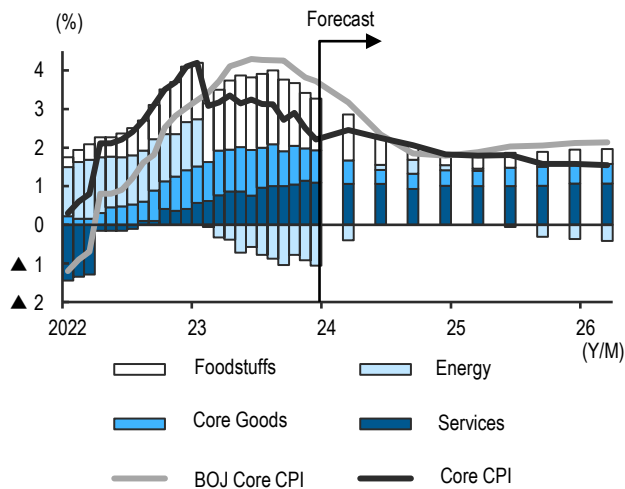
Core CPI growth is expected to slow to around 2% through the second half of 2024. The reduction and termination of the government's countermeasures against higher prices may push up energy prices, and pressure for price hikes on the back of rising wages may intensify. Meanwhile, the trend of price hikes caused by the high cost of raw materials will likely subside.

◆ Long-term interest rates will rise moderately

The Bank of Japan (BOJ) decided to maintain its current accommodative monetary policy at its January 2024 Monetary Policy Meeting. Long-term interest rates in January experienced a modest decline in the first half of the month before picking up in the latter half. The increase in US long-term interest rates, along with the statements from BOJ Governor Ueda, heightened awareness of a potential early policy change by the BOJ.

The BOJ will likely lift negative interest rates after confirming the sustainability of wage hikes through the spring wage offensive and concluding that there is greater certainty of meeting the price target. Long-term interest rates will likely follow a gradual upward trend as the market perceives changes in the BOJ's policies and a continued recovery in the domestic economy.

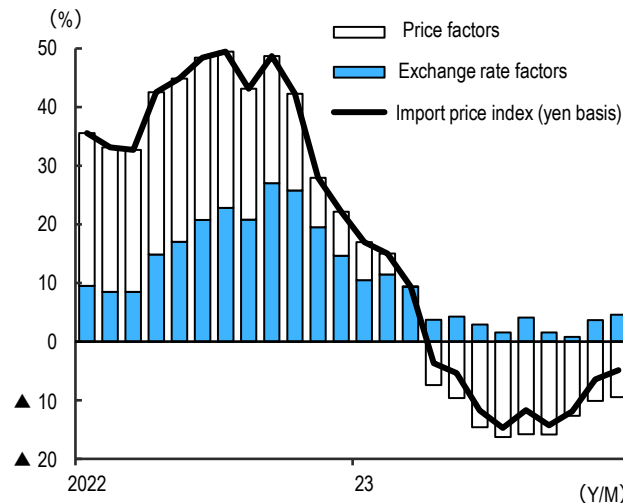
Figure 5-1 Consumer Price Index <YoY>



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

Note: The forecast period is for the quarter. The fuel oil price mitigation measures are assumed to end in April 2024, and the electricity and gas price mitigation measures are assumed to halve in May of the same year and to end in June of the same year.

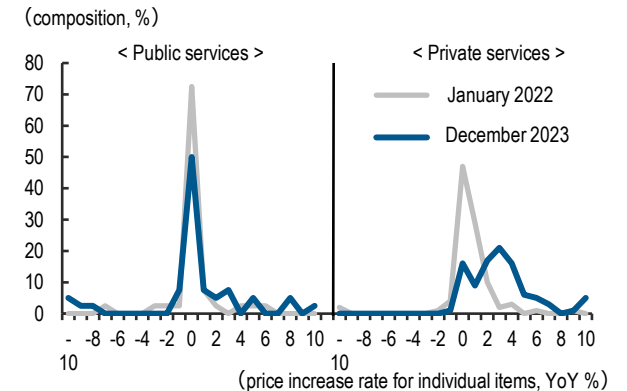
Figure 5-2 Factor Decomposition of Import Price Index <YoY>



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

Note: Price factors are the percentage change in the import price index in contract currency terms.

Figure 5-3 Frequency Distribution of Consumer



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

Note: The histogram ranges from -0.5% to +0.5% y/y, with a width of 1 percentage point (the central 0% range is from -0.5% to +0.5% y/y). The left end of the histogram shows the percentage of items with price increases of less than -9.5% y-o-y, while the right end shows the percentage of items with price increases of 9.5% y-o-y or more.

Topic①: Recovery of inbound tourism demand in local regions remains slow

◆ Disparities lie in the recovery between the Kanto and local regions

While inbound tourism demand is steadily recovering, there is a notable disparity in the pace of recovery between the Kanto region and local regions. Examining the total number of foreign overnight stays proves that the Kanto region, such as Tokyo and Tochigi, has seen a substantial increase of 46.9% compared to pre-COVID-19 levels. In contrast, other local regions have experienced a more modest growth of just 2.8%.

◆ Local regions face challenges in both supply and demand

Three factors could be identified as contributing to this backdrop. Firstly, local regions have failed to capture the increasing number of inbound tourists from Western countries. Most inbound tourists have come from the US, Europe, Australia, and Southeast Asian countries, while the recovery of Chinese tourists to Japan has been slow. However, even before the COVID-19 pandemic, most tourists to local regions came from China, South Korea, and Taiwan, with the number of inbound tourists from other countries being more limited than in the

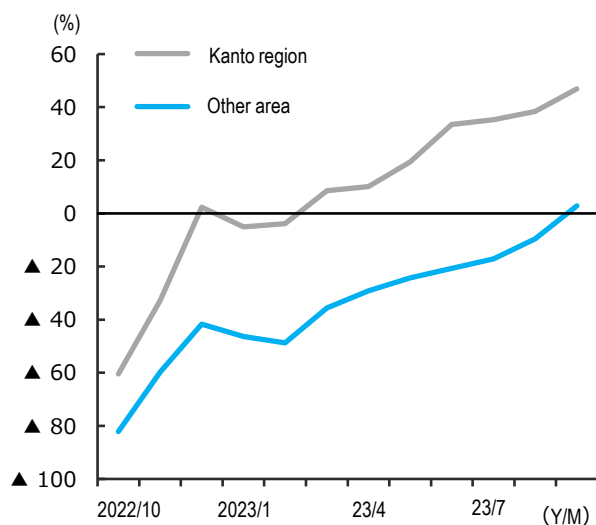
Kanto region. Such a situation remained unchanged even under the current stage.

Secondly, the number of flight operations has yet to recover. Regarding the number of nonstop scheduled international flights in the winter of 2023, the Kanto region has recovered to -6.5% compared to the winter of 2018, whereas the recovery in local regions has significantly lagged at -28.5% during the same period.

Thirdly, labor shortages have worsened. Employment recovery in accommodation and food service industries is slower in local regions than in the Kanto region. The intensifying labor shortage in local regions might have led to a decline in the capacity utilization rate of accommodations and the like.

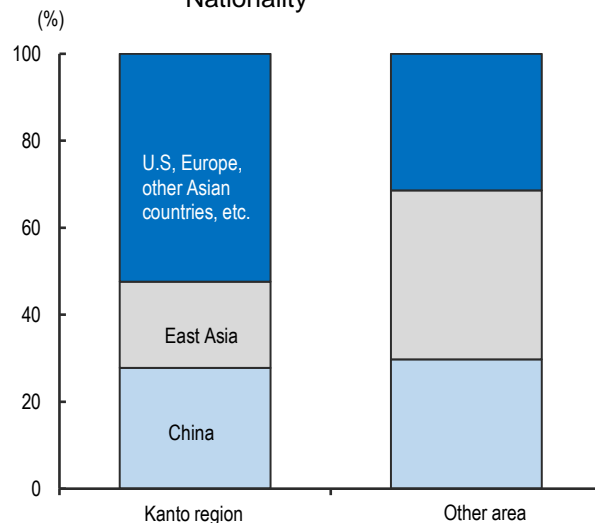
There are challenges in both demand and supply if local regions are to capture inbound tourism demand fully. On the demand side, efforts are required to attract inbound tourists from the US, Europe, and other countries to local regions. On the supply side, it is crucial to enhance the preparedness for hosting inbound tourists by advancing initiatives such as restoring direct flights to local regions and investing in streamlining operations in related services.

Figure 6-1 Total Number of Foreign Guests



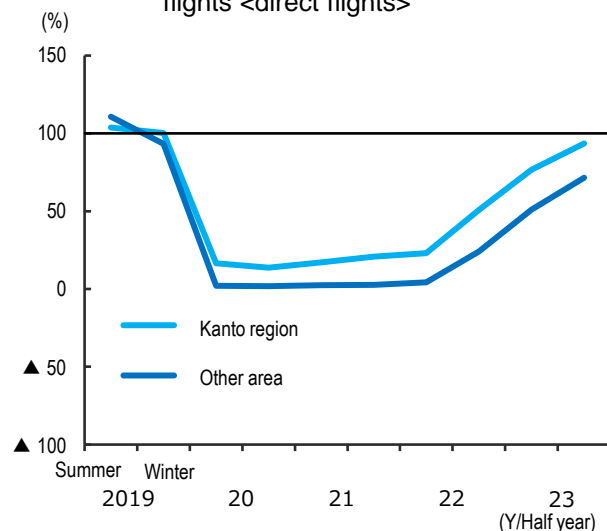
Source: The Japan Research Institute, Ltd. based on data of The Japan Tourism Agency "Lodging Travel Statistics Survey".
 Note: Compared to the same months from October 2018 to September 2019 and from October 2022 to September 2023.
 Note2: Kanto region includes Ibaraki, Tochigi, Gunma, Saitama, Chiba, Tokyo, and Kanagawa prefectures.

Figure 6-2 Total Number of Foreign Guests by Nationality



Source: The Japan Research Institute, Ltd. based on data of The Japan Tourism Agency "Lodging Travel Statistics Survey".
 Note: Total for October 2018-September 2019. East Asia is South Korea, Hong Kong, and Taiwan.

Figure 6-3 The Number of Scheduled International flights <direct flights>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure, Transport and Tourism, "International Flight Status".
 Note: Compared to the same period in summer and winter 2018.

Monthly Report of Prospects for Japan's Economy March 2024
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Topic②: Small businesses face increasingly harsh conditions under the normalization of monetary policy

◆ Small businesses lag in profitability and financial soundness

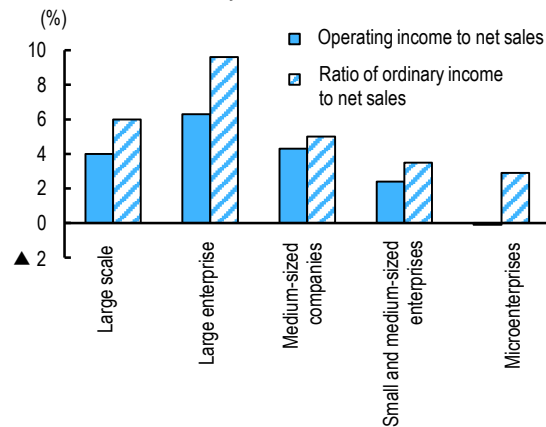
Small businesses fall behind their larger counterparts in terms of profitability and financial soundness. Regarding profitability, indicators such as the ratio of ordinary profit to sales, which reflects a company's overall profitability, and the ratio of operating profit to sales, which represents the profitability of its core business, are lower for smaller businesses. Meanwhile, in terms of financial soundness, small businesses face significant challenges. Their dependency on interest-bearing debt (the ratio of interest-bearing debt to total assets) stands at 61.2%, higher than that of larger firms. Additionally, their interest coverage ratio, a measure of the ability to cover interest expenses with business profits, is negative, highlighting a notably inferior financial situation.

◆ Bankruptcies will increase by 20% with a 3% increase in labor costs and a 2% increase in interest rates

If monetary policy returns to normal with higher wages going forward, the business environment for small businesses could worsen. For instance, when labor costs rise by 3% and borrowing interest rates increase by 2%, smaller businesses experience a more substantial downward impact on ordinary profits. The significant decline in profits on higher interest rates could stem from small businesses having higher debt and less profitability in their core businesses. Additionally, small businesses have higher labor share, resulting in a more significant decrease in profit from increased labor costs.

The declining revenues will, in turn, increase the number of bankruptcies. According to estimates, a 3% increase in labor costs and a 2% increase in borrowing rates would increase the number of corporate bankruptcies by nearly 20% from the previous year.

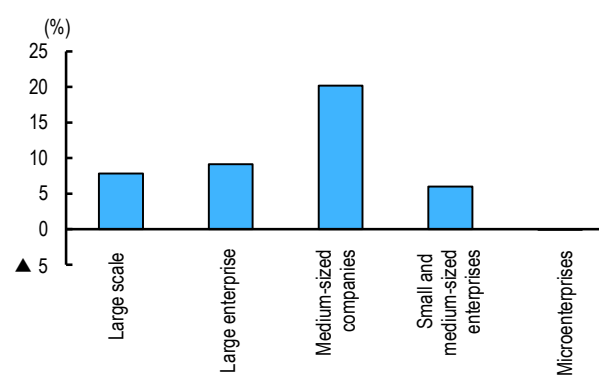
Figure 7-1 Operating Income to Net Sales and Ordinary Income to Net Sales <FY2022>



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

Note: Large companies: capital of 1 billion yen or more; medium-sized companies: capital of 100 million yen or more but less than 1 billion yen; small and medium-sized companies: capital of 10 million yen or more but less than 100 million yen; micro companies: capital of less than 10 million yen.

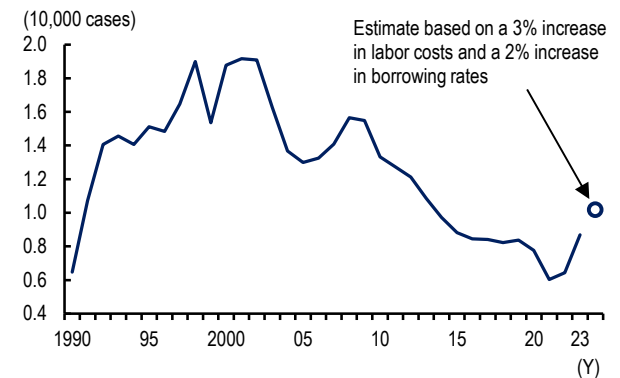
Figure 7-2 Interest Coverage Ratio <FY2022, by company size>



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

Note: Interest coverage ratio = operating income, interest expense, etc., as interest income, etc., is not disclosed in the Annual Report of Corporate Statistics. Large companies are those with capital of 1 billion yen or more, medium-sized companies are those with capital of 100 million yen or more but less than 1 billion yen, small and medium-sized companies are those with capital of 10 million yen or more but less than 100 million yen, and micro companies are those with capital of less than 10 million yen.

Figure 7-3 The Number of Corporate Bankruptcies



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

Note: The impact of labor costs and interest rate hikes on the number of bankruptcies is estimated using quarterly data. The estimation formula is $\Delta \text{LN}(\text{number of bankruptcies}) = -0.136 * \Delta \text{Ordinary profit to sales ratio of small and medium-sized enterprises} + 0.007$. The estimation period is from Jan-Mar 1990 to Jul-Sep 2023. Return on sales is a backward-looking four-quarter moving average.

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The Japan Research Institute, Limited

Japan economic forecast: FY23: +1.3%, FY24: +0.7%

◆ Strong corporate earnings act as a starting point

The January-March quarter will likely experience a temporary standstill. Consumer spending and goods exports will likely weaken due to the impact of the suspension of shipments by some automakers.

The Japanese economy will gradually recover from the April-June quarter, primarily led by domestic demand. Strong corporate earnings will likely lead to positive spending, including wage increases that outpace higher prices and an expansion of future-oriented capital spending.

Personal consumption will recover moderately, mainly supported by improvements in the employment and income environment. The rate of wage increases in the spring wage offensive of this year will surpass last year's. Wages for non-regular employees, less likely to be affected by the spring wage offensive, will also rise amid a worsening labor shortage and an increase in the minimum wage.

Capital investment by companies will increase, underpinned by high corporate earnings. Amid a worsening labor shortage, digital investment will increase mainly for labor-saving purposes, and the onshoring of production bases will also progress.

◆ The growth rate for FY2024 will be 0.7%

The real growth rate will be +1.3% in FY2023, +0.7% in FY2024, and +1.1% in FY2025, respectively. The growth rate will remain in the 0% range in FY2024 due to the weak economy in the second half of FY2023, but will return to the 1% range in FY2025.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of February 15, 2024)

(%, changes from the previous fiscal year)

	CY2023	CY2024					CY2025				CY2026	FY2023	FY2024	FY2025
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)			
	(Actual)	(Projection)												
Real GDP	▲ 0.4	0.6	1.6	1.0	1.1	1.0	1.1	1.1	1.0	1.1	1.3	0.7	1.1	
Private Consumption Expenditure	▲ 0.9	▲ 0.2	1.9	0.6	1.0	0.9	0.8	0.8	0.7	0.7	▲ 0.4	0.5	0.8	
Housing Investment	▲ 4.0	0.0	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 0.2	▲ 0.3	▲ 0.3	▲ 0.3	1.4	▲ 0.7	▲ 0.2	
Business Fixed Investment	▲ 0.3	1.5	2.4	2.9	2.4	1.8	2.0	2.2	2.2	2.0	▲ 0.6	1.7	2.1	
Private Inventories (percentage points contribution)	(▲ 0.1)	(0.0)	(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	▲ 0.5	0.2	0.1	0.0	0.0	0.0	0.2	0.2	▲ 0.3	0.0	0.5	0.1	0.1	
Public Investment	▲ 2.8	1.2	1.2	1.0	0.8	0.8	0.8	0.4	0.4	0.4	2.8	0.4	0.7	
Net Exports (percentage points contribution)	(0.8)	(0.4)	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(1.6)	(0.3)	(0.2)	
Exports of Goods and Services	11.0	▲ 0.0	1.8	1.7	2.2	2.7	2.9	3.1	3.4	3.5	4.4	2.8	2.9	
Imports of Goods and Services	7.0	▲ 1.9	1.2	1.3	1.5	1.7	1.8	1.9	2.0	2.0	▲ 2.6	1.6	1.8	

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	4.9	4.1	2.1	2.7	2.6	2.0	1.8	2.1	2.2	2.3	5.5	2.4	2.1
GDP deflator	3.8	3.7	2.4	2.0	1.6	0.7	0.8	1.0	1.1	1.2	4.1	1.7	1.0
Consumer Price Index (excluding fresh food)	2.5	2.5	2.3	2.1	1.8	1.8	1.8	1.6	1.6	1.5	2.8	2.0	1.6
Unemployment Rate (%)	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.2	2.2	2.2	2.5	2.3	2.2
Exchange Rates (JY/US\$)	148	145	142	139	136	134	132	130	129	128	144	138	130
Import Price of Crude Oil (US\$/barrel)	93	80	78	80	82	81	76	74	73	72	85	80	74

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.