Monthly Report of Prospects for Japan's Economy

April 2024

Macro Economic Research Center

Economics Department

The Japan Research Institute, Limited

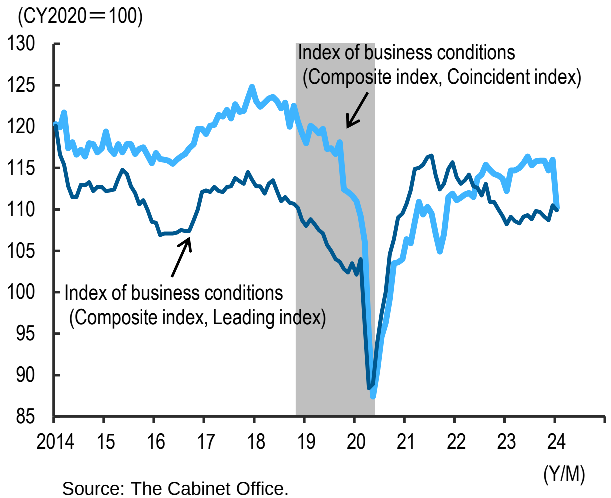
https://www.jri.co.jp/english/periodical/

This report is the revised English version of the March 2024 issue of the original Japanese version.

The General Situation – The economic recovery has stalled

Figure 1-1 Economic Activity

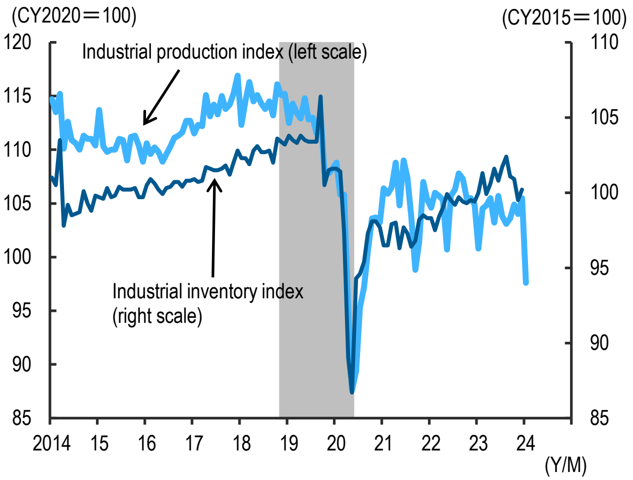
The coincident index of business conditions is treading water.
The leading index is more or less unchanged.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

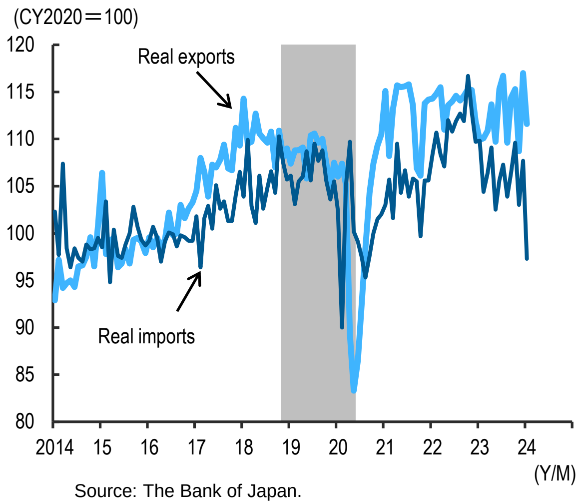
Industrial production is declining in most industries.
Economic activity in the service sector has been weak since last fall.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

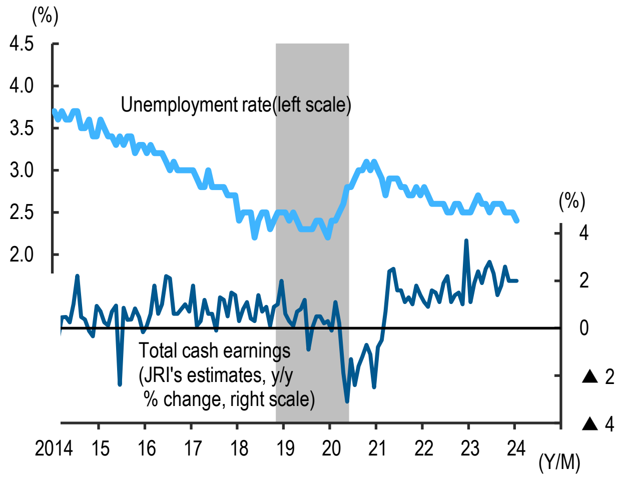
Exports are fluctuating, but remain flat overall.
Imports, especially energy-related, have fallen substantially.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

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

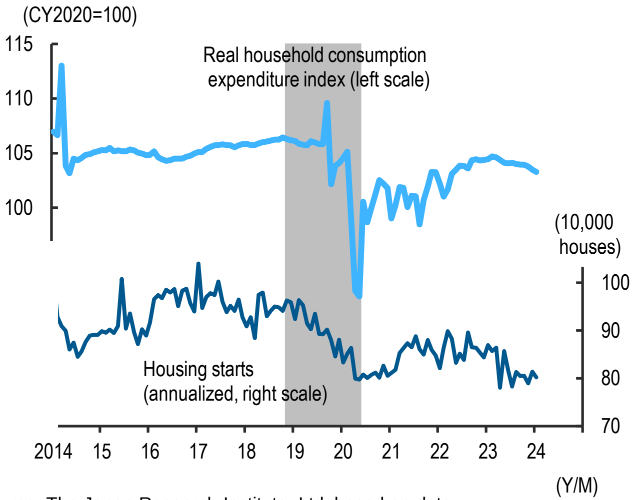


Source: The Ministry of Internal Affairs and Communications,
The Ministry of Health, Labor and Welfare.

＊The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

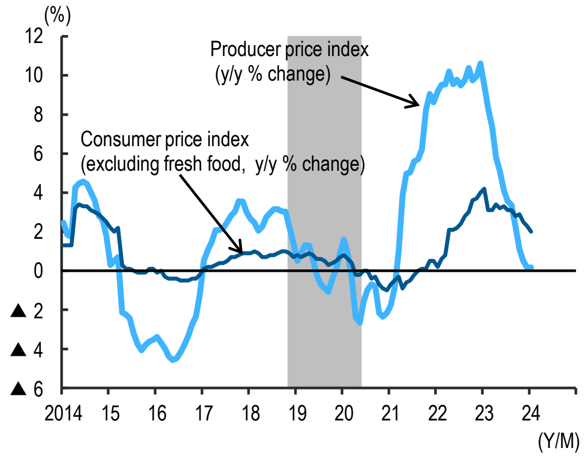
Consumption is currently weak.
Housing starts are sluggish.



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 has plummeted to the 0% range.
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.

GDP growth for October-December 2023 has been revised upward, putting it in positive territory

◆ Capital investment has been revised upward considerably

In the second QE for October-December 2023, real GDP growth was revised upward to +0.4% quarter over quarter (QoQ) at an annualized rate (+0.1% QoQ) from -0.4% (-0.1% QoQ) in the first QE. Breaking this down by demand component, capital investment was revised upward substantially. Despite the positive growth, domestic demand, especially personal consumption, declined for the third consecutive quarter, and the assessment that the economic recovery has stalled remains unchanged.

◆ Manufacturing activity has temporarily stalled

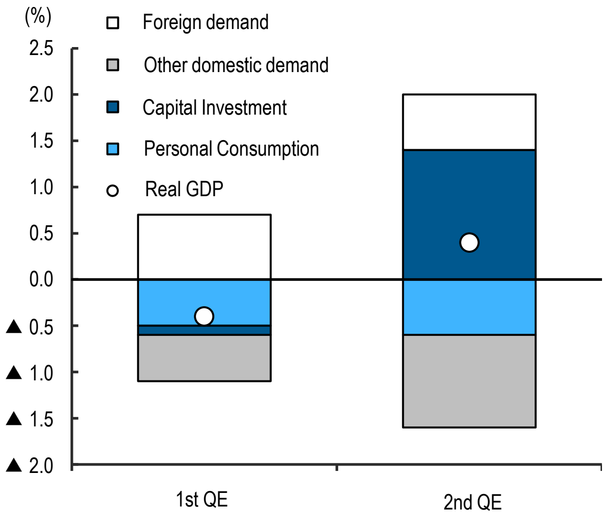
In January, the Industrial Production Index fell for the first time in two months, dropping 7.5% from the previous month. By sector, companies in a wide range of industries, and particularly ones in the automobile industry, reduced production. Background factors included the suspension of automobile shipments by certain manufacturers due to performance test irregularities.

Near-future production plans indicate increases in output in February (+4.8% month over month (MoM)) and March (+2.0% MoM). Automakers where misconduct has come to light have only resumed output and shipment of a limited number of vehicle models, so a full-scale recovery in production is expected to take time.

◆ Business confidence is improving

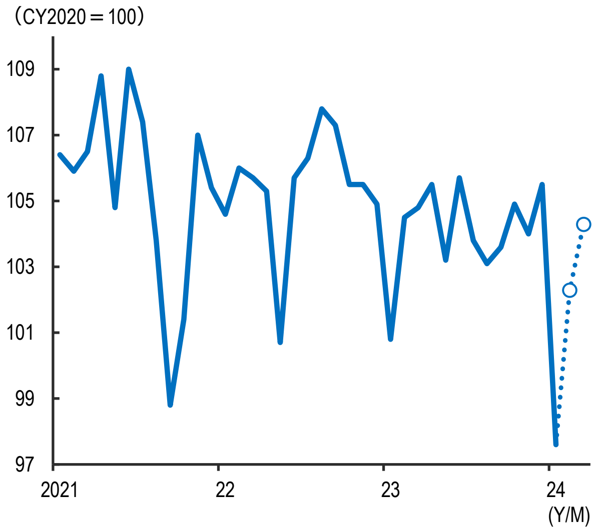
The diffusion index (DI) for current economic conditions in the Economy Watchers Survey for February climbed for the first time in two months, edging up 1.1 points from the previous month. Breaking this down, while the employment-related DI declined, the DIs for household activity and corporate activity rose. By geography, the Hokuriku region's DI, which had fallen sharply the previous month due to the Noto Peninsula earthquake, climbed 9.2 points from the previous month to recover to its pre-earthquake level.

Figure 2-1 Real GDP growth rate for Oct-Dec 2023 <YoY annual growth rate>



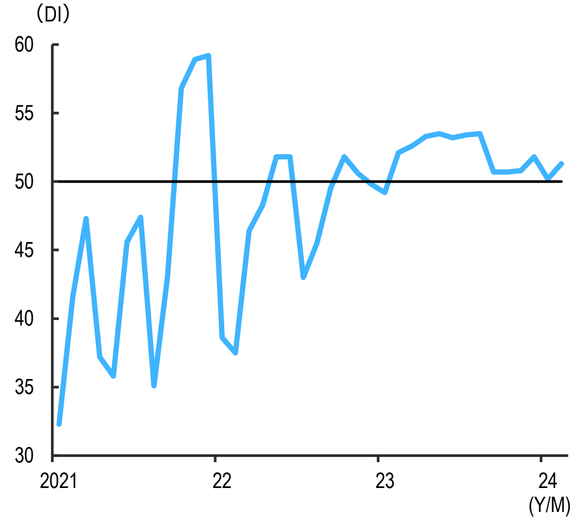
Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

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 (February and March).

Figure 2-3 DI of Current Economic Conditions



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

Capital investment is increasing thanks to strong corporate earnings

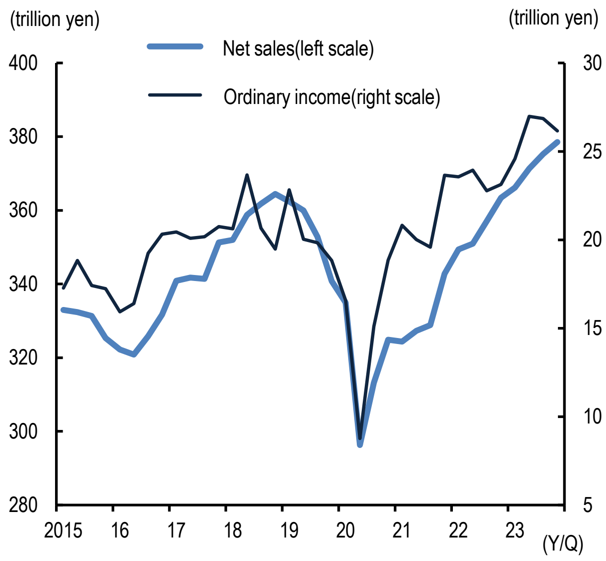
◆ Corporate earnings remain high overall

According to the Financial Statements Statistics of Corporations, net sales for the October-December quarter in 2023 edged up 0.9% QoQ, rising for the 11th consecutive quarter. Sectors such as transportation machinery, production and exports of which have increased thanks to the resolution of supply constraints, are now the main driver. However, ordinary profit dipped 2.6% QoQ, falling for the second quarter in a row. Increased labor costs and other factors are putting pressure on earnings. Corporate earnings in the January-March quarter are expected to be temporarily lower due to such factors as automobile production cuts. Thereafter, corporate earnings look set to return to an expansionary trend as a recovery in domestic and foreign demand boosts sales.

◆ Capital investment is increasing significantly

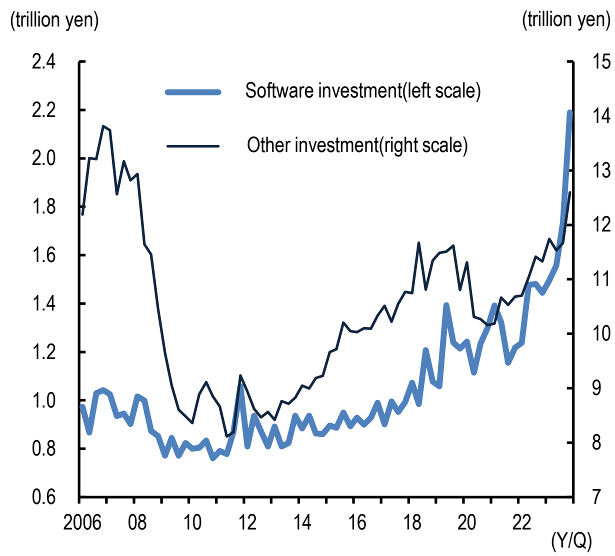
According to the Financial Statements Statistics of Corporations, capital investment in October-December 2023 jumped 10.4% QoQ, a substantial rise. By type, software investment was strong due to rising labor-saving needs stemming from the labor shortages facing companies. And against the backdrop of a pickup in foreign demand, investment in machinery to increase production capacity also increased. Capital investment is expected to continue to rise going forward. With expected growth rates higher, corporate appetite for capital investment will remain strong over the medium to long term. According to a survey on corporate behavior conducted in FY2023, the projected growth rate of corporate capital investment over the next three years (annual average) is +6.8% for all industries, the highest growth since FY1990. Particularly high growth is expected in the precision machinery sector, which includes semiconductor-related industries, and this will become the driving force for future capital investment.

Figure 3-1 Net Sales and Ordinary Income of Corporate Enterprises <seasonally adjusted>



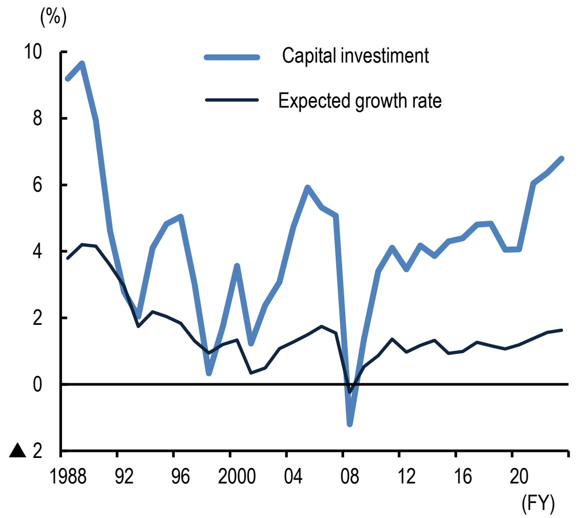
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note: All sizes and all industries (excluding finance and insurance).

Figure 3-2 Capital Investment by Corporate Enterprises



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.
Note:All sizes and all industries (excluding finance and insurance).

Figure 3-3 Expected Growth Rate and Capital Expenditure Forecast <next 3 years>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.
Note:All industries, listed companies. Expected growth rate is the real growth rate of industry demand.

The household income situation is gradually improving

◆ The household income situation is gradually improving

In January, basic salaries of regular employees increased by 1.6% year over year (YoY), showing continued moderate growth. The hourly pay of part-time workers climbed 3.7% YoY, continuing to rise at a rapid clip. However, the average rise in workers' wages is still not keeping pace with consumer price inflation, with real wages falling 0.6% YoY for the 22nd 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 4.2% in the 2024 shunto (spring wage offensive), higher than it was last year. According to a tally from RENGO (Japanese Trade Union Confederation), labor unions are demanding wage hikes of 5.85% on average, a bigger increase than they called for last year, and numerous companies, mainly large corporations, have agreed to the full amount of increase demanded by their respective unions.

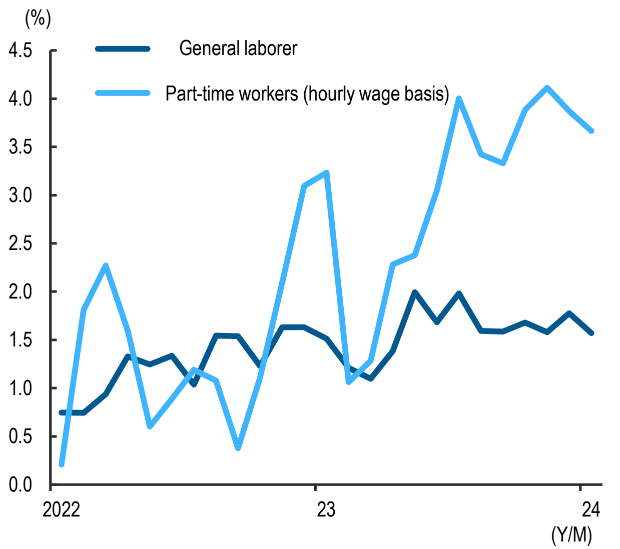
◆ Durable goods consumption has plummeted recently

In January, the Consumption Activity Index rose for the first time in two months, increasing 0.3% from the previous month, yet consumption remains weak. Although consumption of services such as dining out picked up, durable goods consumption declined sharply due to the halting of shipments by some automakers. For the time being, the impact of automakers' suspensions of shipments may weigh on personal consumption. Thereafter, personal consumption is expected to recover, supported by an improved income environment and the wealth effect of rising stock prices.

◆ Consumer confidence is improving

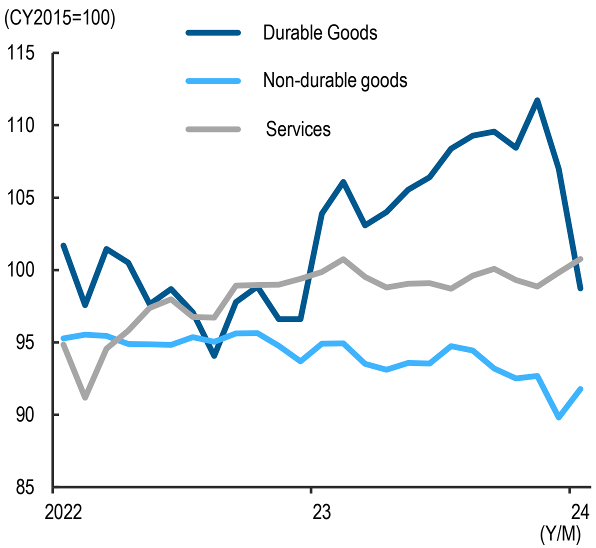
In February, the Consumer Confidence Index increased for the fifth consecutive month, up 1.1 points from the previous month. Dividing this into its component categories, the indices for overall livelihood and income growth rose against a backdrop of slower price increases and expectations for wage hikes.

Figure 4-1 Basic Salary<YoY>



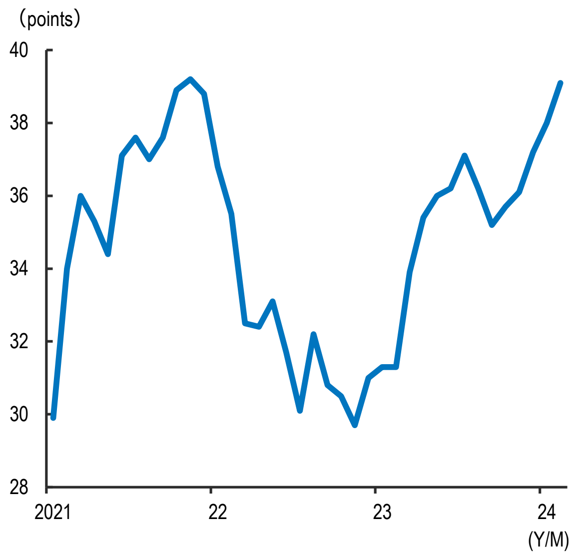
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labour and Welfare.
Note: Adjusted for data fault caused by the replacement of surveyed firms. The data for January 2024 has not been adjusted.

Figure 4-2 Consumption Activity Index <seasonally adjusted>



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

Figure 4-3 Consumer Attitude Index <seasonally adjusted>



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

Price hikes resulting from rising wages are spreading to private-sector services

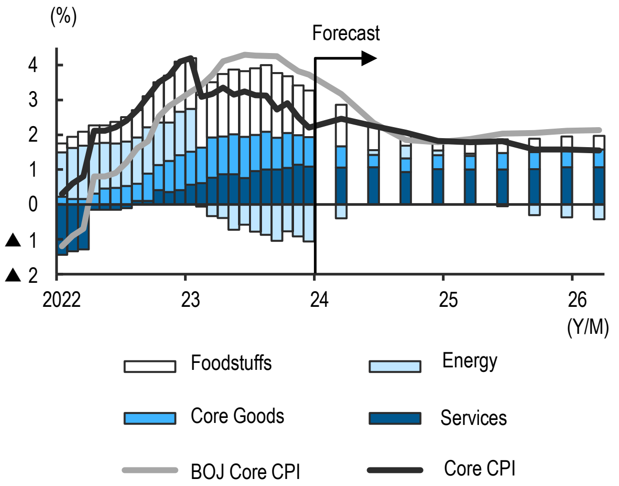
◆ Imported inflationary pressure is easing

In January, core consumer price inflation slowed from the previous month to 2.0%. The pace of energy price declines increased due to the impact of the large rises in electricity and gas prices in the previous year. Furthermore, increases in prices of other goods slowed, with the retreat of imported inflationary pressure the principal factor. However, prices of services are still rising rapidly. While prices for most public-sector services remain unchanged, an increasing number of private-sector services are seeing 2-3% price rises. Higher wages are increasingly being passed on to prices of private-sector services in areas such as transportation and education. For the time being, the core CPI is expected to keep rising at a pace of above 2%. While the trend of hiking prices due to rising raw material prices should dissipate, higher wages are expected to intensify upward pressure on prices. Furthermore, the government's reduction/termination of its measures to ease the pain of inflation is predicted to push up energy prices.

◆ Long-term interest rates will rise gradually

At its January Monetary Policy Meeting, the Bank of Japan (BOJ) decided to maintain its current accommodative monetary policy. Long-term interest rates were more or less flat in February amid mixed speculation over monetary policies in Japan and the U.S. Looking ahead, the BOJ is expected to scrap negative interest rates, once it has confirmed the sustainability of wage rises through the shunto and deemed that achievement of its inflation target has become more certain. Long-term interest rates are expected to follow a gradual upward trend due to policy changes by the BOJ and realization that the domestic economic recovery is being sustained.

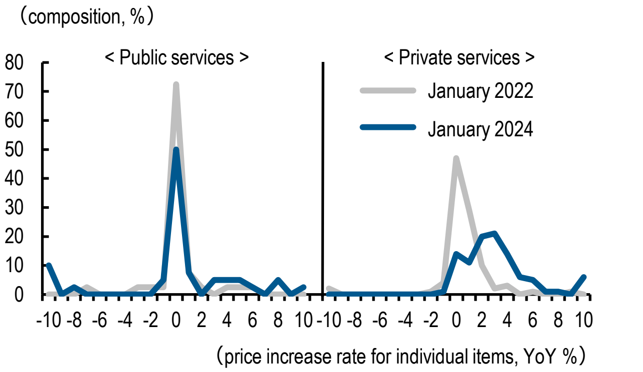
Figure 5-1 Consumer Price Index <YoY>



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.

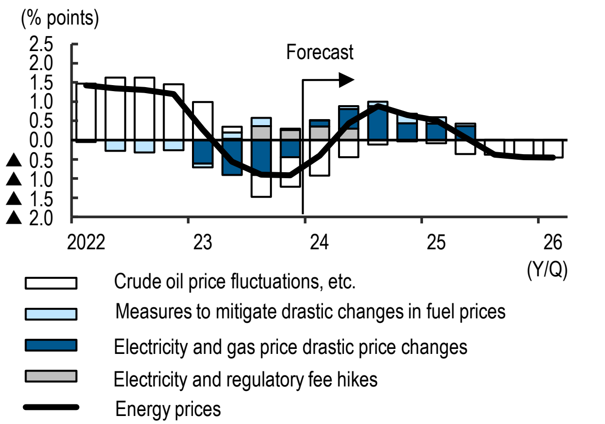
Figure 5-2 Frequency Distribution of Consumer Price Inflation



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

Note:The histogram is 1 percentage point wide (the central 0% range is from -0.5% to +0.5%). The left end of the histogram shows the percentage of items that were less than -9.5% of the previous year's level, while the right end shows the percentage of items that were more than 9.5% of the previous year's level.

Figure 5-3 Year-on-Year Contribution of Energy Prices to Core CPI



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

Note:Fuel oil price mitigation measures are assumed to end in April, while electricity and gas price mitigation measures are assumed to halve discounts in May and end in June.

Topic①: Fluctuations in the real-estate market will require attention as interest rates rise

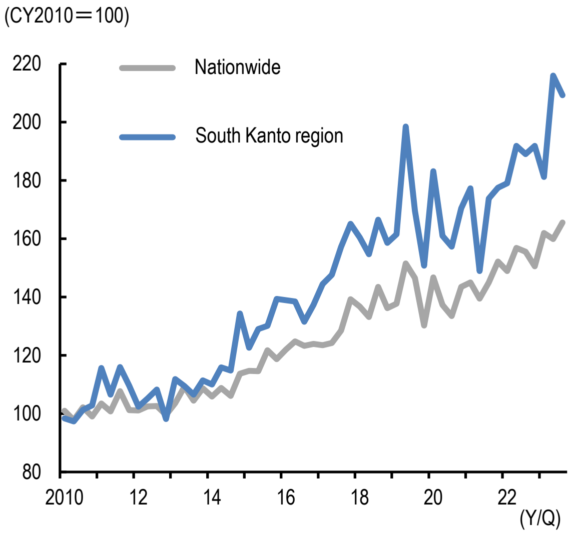
◆ The real-estate market is booming

Property prices in Japan are rising. Commercial real-estate prices are rising on average nationwide, with office prices more than doubling since 2010 in the southern Kanto region, which includes Tokyo. Background factors include domestic and foreign investment money flowing into the property market as a result of the long-standing low interest rate policy. Even now, rates of return on office investment in Tokyo are high by international standards, giving overseas investors powerful motivation to invest. Against the backdrop of this booming real-estate market, property developers have been aggressively investing in the construction/refurbishment of office buildings and retail facilities. Capital investment in the real estate sector as a percentage of GDP has reached its highest level since the bubble economy of the late 1980s.

◆ Rising interest rates will be a cause for concern going forward

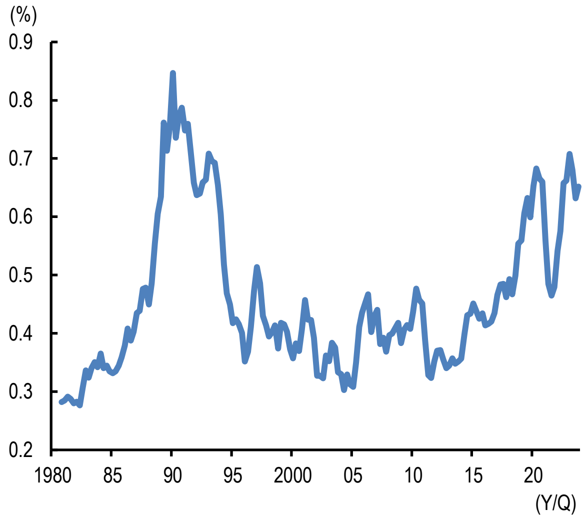
Looking ahead, however, interest rate rises could dampen the mood. In the office market, the recovery in demand has been sluggish due to factors such as the proliferation of telecommuting, and vacancy rates have remained high since the COVID pandemic. Amid weak real demand, higher interest rates could squelch demand by making borrowing more expensive, leading to drops in capital investment and real-estate prices. Property price falls might adversely impact the performance of financial institutions by reducing the earnings of companies in the sector and causing collateral values to decline. Among financial institutions, lending to real-estate firms as a percentage of total lending is on the rise, and this trend is particularly pronounced among shinkin banks (credit unions). There is also a risk that financial institutions will become more stringent in their lending stances as market conditions worsen, and small and medium-sized enterprises (SMEs) could have difficulty in raising funds.

Figure 6-1 Commercial Real EstatePrices <office>



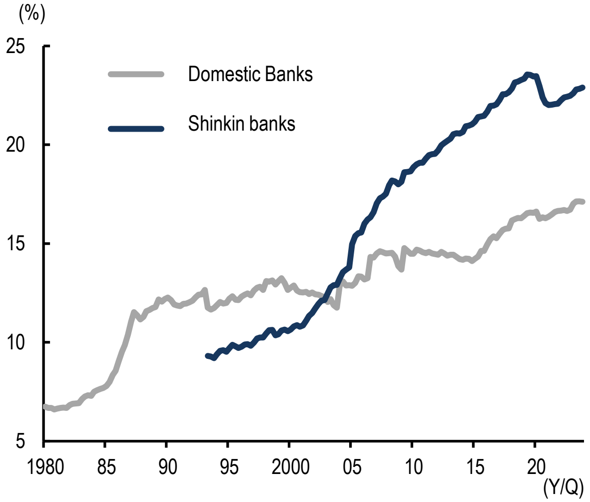
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure, Transport and Tourism.
Note:Land price with building.

Figure 6-2 Capital Investment in Real Estate <% of GDP>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Cabinet Office.
Note:Backward-looking four-period moving average.

Figure 6-3 Percentage of Loans to The Real Estate Industry



Source: The Japan Research Institute, Ltd. based on date of The Bank of Japan.
Note:Including loans by individuals to the home lending industry.

Topic②: Wealth effects expected for a wide range of households

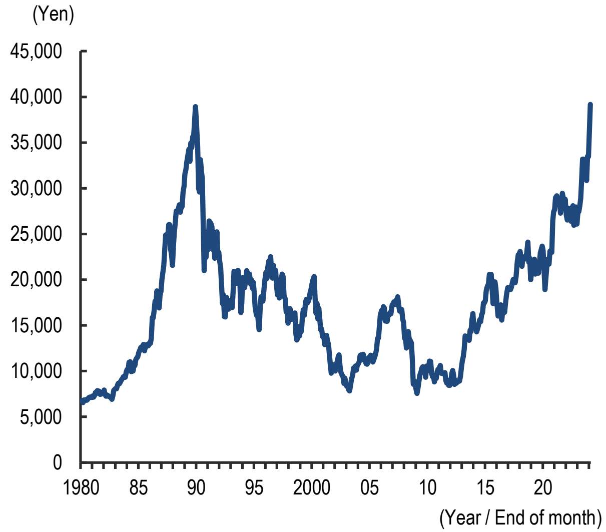
◆ The Nikkei Stock Average hits an all-time high

In late February, the Nikkei Stock Average hit a record high for the first time since the bubble era. Even since then it has stayed high, at one point rising above 40,000 yen. Higher stock prices increase the value of the financial assets held by households, and personal consumption could be boosted as income from assets rises and sentiment improves (i.e., due to the wealth effect). It is estimated that if the Nikkei Stock Average remains at its current level, personal consumption will increase by 0.8% YoY.

◆ Consumption could be boosted across a wide range of households

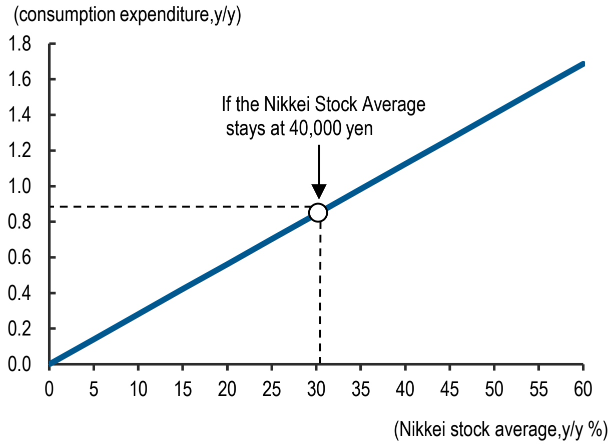
Wealth effects tend to vary widely depending on household attributes. If the value of assets such as stocks rises by 100 yen, consumption increases by 6.0 yen for elderly households (i.e., households headed by a person aged 60 or older), yet by just 0.8 yen for young and middle-aged households (i.e., households headed by a person aged 59 or younger). This is due to the fact that ownership of stocks and equity funds has long been skewed toward elderly households, with young and middle-aged households less likely to hold such assets. However, this trend may have changed recently. Against the backdrop of the launch of the new, expanded NISA system of tax-free dividends and capital gains, holdings of stocks and mutual funds are rising not only among the elderly but also among young and middle-aged people. Therefore, if stock prices continue to rise, the asset effect could increase for a wide range of generations.

Figure 7-1 Nikkei Stock Average



Source: NEEDS-FinancialQUEST.

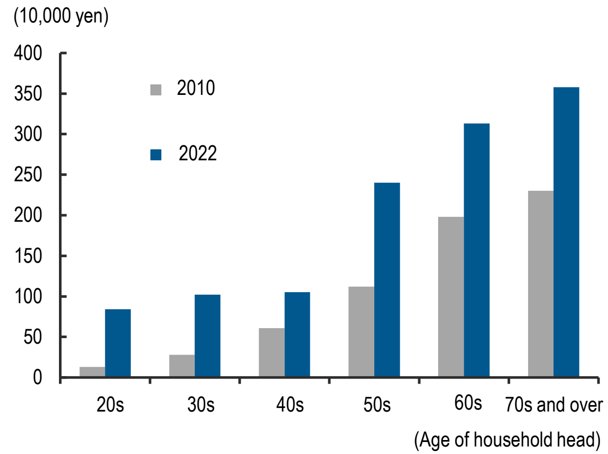
Figure 7-2 Effect of Higher Stock Prices on Boosting Personal Consumption <2024>



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

Note: Calculated based on the elasticity of consumption to stocks and stock investment trusts estimated in the lower left annotation. Assumes that stocks and stock investment trusts held by households are linked to the Nikkei Stock Average.

Figure 7-3 Stock and Stock Investment Trust Holdings



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

Note:Households with two or more persons.

Japan economic forecast: FY23: +1.4%, FY24: +0.7%

◆ Strong corporate earnings will serve as a launchpad

Looking ahead, the economy is expected to stall temporarily in the January-March quarter. The impact of certain automakers' suspensions of vehicle shipments could cause personal consumption and goods exports to weaken.

From April-June onward, the economy is expected to recover moderately, led 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 more future-oriented capital investment.

Personal consumption is expected to gradually recover, supported by an improved employment/income environment and the wealth effect of rising stock prices. Rates of wage increases agreed at this year's shunto should be higher than last year's. Wages for non-regular workers, which are less affected by shunto trends, are also expected to rise due to intensifying labor shortages and higher minimum wages.

Capital investment should continue to increase thanks to strong corporate earnings. In addition to stepping up digital investment for labor-saving amid increasingly severe labor shortages, companies are expected to accelerate moves to relocate production back to Japan.

◆ The growth rate for FY2024 will be 0.7%

Real growth is projected to have been +1.4% in FY2023 and to be +0.7% in FY2024, and +1.1% in FY2025. Due to the weak economy in the second half of FY2023, the growth rate is expected to remain in the zero percent range in FY2024, but it should return to the 1% level in FY2025.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of March 11, 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			
	(Actual)	(Projection)									(Projection)		
Real GDP	0.4	0.4	1.7	1.0	1.1	1.0	1.1	1.1	1.0	1.1	1.4	0.7	1.1
Private Consumption Expenditure	▲ 1.0	▲ 0.2	2.1	0.8	1.1	1.0	0.9	0.8	0.8	0.8	▲ 0.4	0.6	0.9
Housing Investment	▲ 3.9	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	8.4	▲ 0.3	2.2	2.0	2.0	1.8	2.0	2.1	2.2	2.0	0.8	2.2	2.0
Private Inventories (percentage points contribution)	(▲ 0.5)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.3)	(▲ 0.2)	(▲ 0.0)
Government Consumption Expenditure	▲ 0.7	0.2	0.1	0.0	0.0	0.0	0.2	0.2	▲ 0.3	0.0	0.5	0.0	0.1
Public Investment	▲ 3.0	1.2	1.2	1.0	0.8	0.8	0.8	0.4	0.4	0.4	2.7	0.3	0.7
Net Exports (percentage points contribution)	(0.8)	(0.4)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(1.6)	(0.2)	(0.2)
Exports of Goods and Services	10.7	▲ 0.0	1.8	1.7	2.2	2.7	2.9	3.1	3.4	3.5	4.4	2.7	2.9
Imports of Goods and Services	6.9	▲ 1.9	1.3	1.4	1.6	1.8	1.9	1.9	2.1	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	5.1	4.4	2.5	3.5	3.5	3.0	2.6	2.6	2.5	2.6	5.6	3.1	2.6
GDP deflator	3.9	3.7	2.6	2.6	2.5	1.7	1.6	1.5	1.4	1.5	4.1	2.4	1.5
Price Index (excluding fresh food)	2.5	2.4	2.6	2.6	2.3	2.2	1.9	1.5	1.5	1.5	2.8	2.4	1.6
nent 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
Rates (JY/US$)	148	148	145	143	140	138	136	134	132	130	145	142	133
e of Crude Oil (US$/barrel)	93	83	84	85	84	82	79	77	76	74	85	83	77

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.