

Monthly Report of Prospects for Japan's Economy

February 2020

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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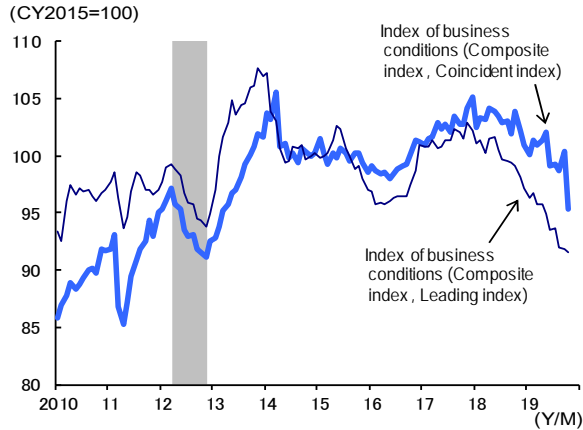
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The General Situation of Japan's Economy – A Sense of Standstill Is Felt in Economic Activity

Figure 1-1 Economic Activity

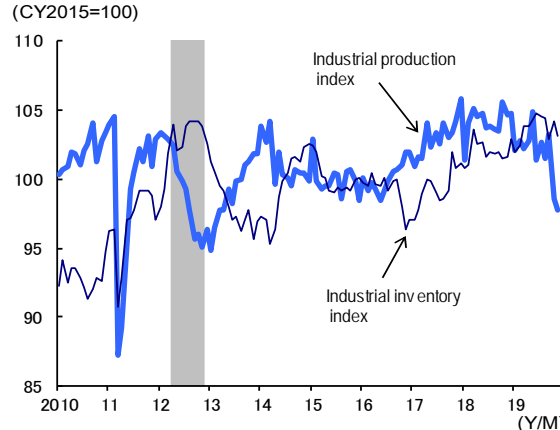
The CI coincident index declined significantly due to a decrease in retail and wholesale sales. The leading index also remained on a declining trend.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

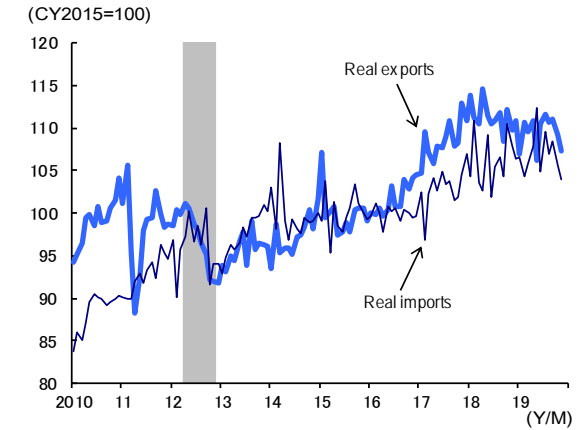
Industrial production plunged against the backdrop of sluggish overseas demand and higher inventories, among other factors.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

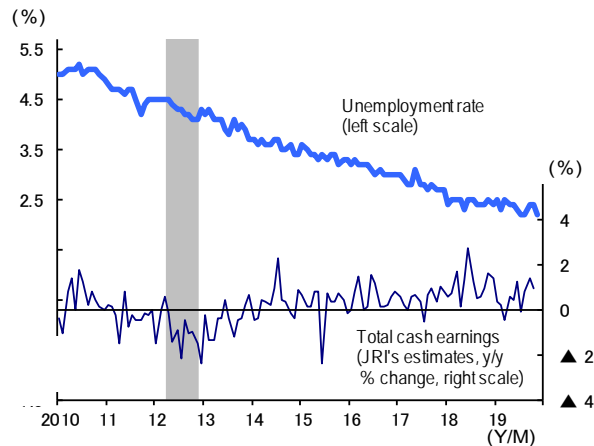
Exports, mainly to the United States and Europe, declined. Imports of crude oil and mobile phones also decreased.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is hovering around its lowest level since 1992. Nominal wages have been on a rising trend despite some ups and downs.

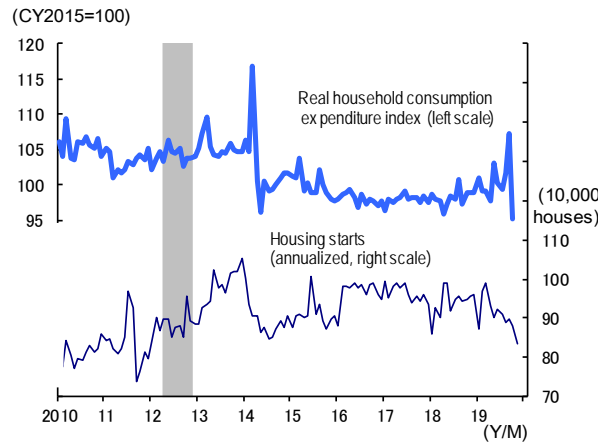


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

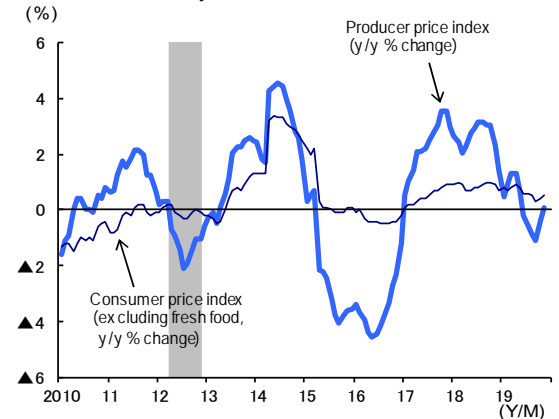
Real household consumption plunged significantly due to the reaction following the rush in demand prior to the tax hike. Housing starts saw a decline, mainly for subdivision houses.



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

Figure 1-6 Prices

Producer prices picked up, mainly for petroleum products. The pace of increase in consumer prices remained virtually flat.



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

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Nonmanufacturing Stays Firm, While Manufacturing Production Activities Remain Sluggish

◆ The DI for Business Conditions Declined

In the Bank of Japan's December 2019 Tankan Survey, the large manufacturers' DI for business conditions was down 5 percentage points from the previous survey, showing a decline for four consecutive quarters and dropping to the zero level. The DI plunged substantially mainly for general machinery and automobile manufacturers against the backdrop of sluggish exports in line with the slowdown of overseas economies and the suspension of production due to the large-scale typhoons.

At the same time, the DI for large nonmanufacturers remained at a high level, although it declined for the second consecutive quarter, down 1 percentage point from the previous survey. The DI saw a decline in the retail and other consumption related sectors, while the DI remained firm for information services on the back of the expansion of software investment.

In terms of future outlook, the DI is anticipated to deteriorate, dropping 4 percentage points across businesses of all sizes and in all industries. Concerns over

a decline in domestic consumption following the hike in the consumption tax rate will likely apply downward pressure.

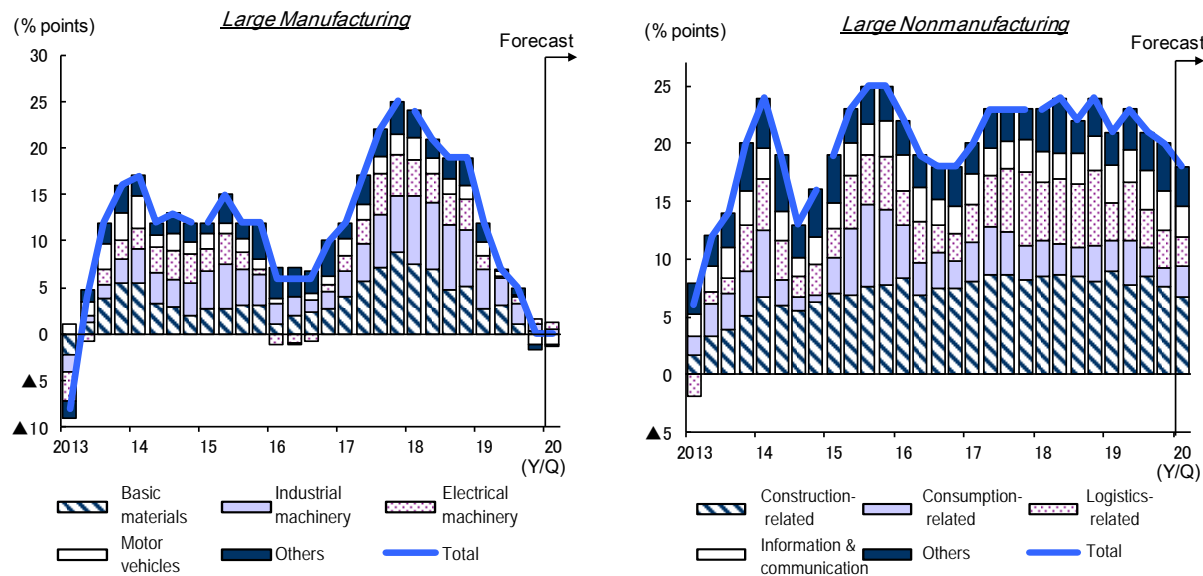
◆ Industrial Production Remained Weak

The Industrial Production Index for November plunged 1.0% from the previous month, showing a decline for the second consecutive month. Looking at future production plans, industrial production is forecast to increase by 2.8% month-over-month in December and by 2.5% month-over-month in January 2020, returning to the level of September. However, the Industrial Production Index may be revised downward as inventory levels have remained high and the index has continued to fall below the planned level.

◆ Private Consumption Declined Temporarily

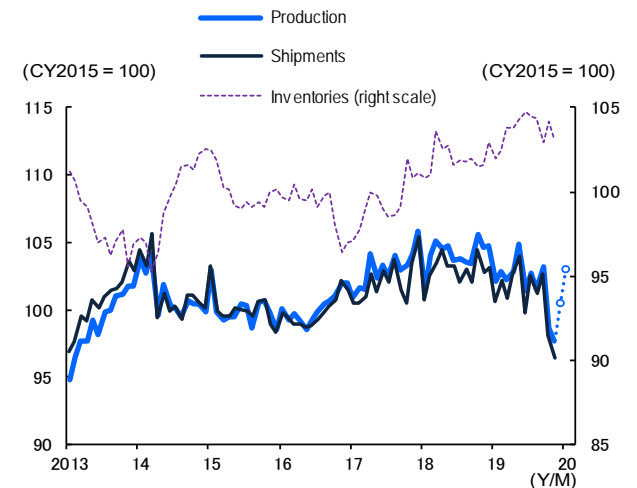
The real consumption activity index for October declined mainly for durable goods due to the impact of the typhoon as well as the reaction to the rush demand prior to the consumption tax rate hike.

Figure 2-1 Contributions to the Business Conditions Diffusion Index by Industry
<diffusion index of "favorable" minus "unfavorable," and percentage point contribution to total DI points>



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

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: The latest two figures in the industrial production index are forecasts for December 2019 and January 2020 based on the production forecast index.

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Exports Remain Lackluster

◆ Exports of Transport Equipment Declined

Exports of goods have been sluggish since the beginning of 2019. In particular, there has been a marked decline in exports of transport equipment. Especially, exports of transport equipment to the United States, which takes a high proportion of overall exports, declined sharply against the backdrop of the shift toward local production of finished vehicles which had previously been exported from Japan.

Regarding future prospects, Japan's exports of transport equipment to the United States are anticipated to remain lackluster, and amid the lack of momentum for the global economy on the whole, a strong recovery of overall exports of goods will be difficult to achieve. However, there have been signs of improvement in the trend of global capital investment which had been restrained, as evidenced by an increase in China's machinery imports, in addition to a recovery in semiconductor demand. As for the future prospects, exports will likely pick up moderately, mainly for electronic

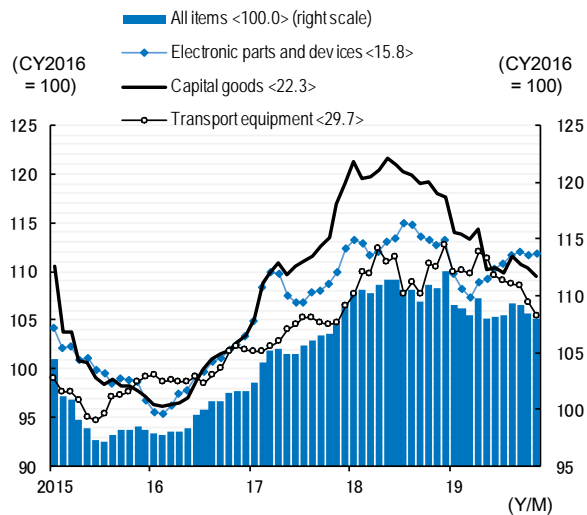
components and capital goods.

◆ Demand Related to Inbound Tourism Continued to Decline

The number of tourists that visited Japan in November increased by 6.1% from the previous month. While the number of South Korean tourists visiting Japan continued to decline against the backdrop of the deterioration in the relationship between Japan and South Korea, the number of tourists visiting Japan from China and other countries increased thanks to an increase in air seat supply as a result of the launch of new flight services and an increase in the number of flights.

As for the future outlook, although the number of tourists from emerging Asian countries is expected to continue to increase on the back of an increase in the number of middle-income earners, the number of visitors to Japan is expected to continue falling below the previous year's level for the time being due to the prolonged slump in the number of South Koreans visiting Japan.

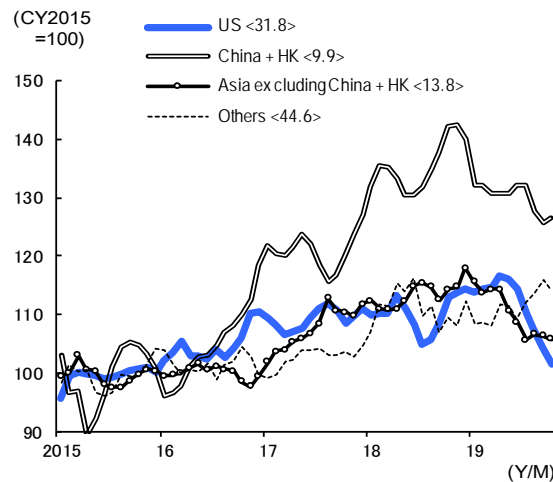
Figure 3-1 Real Exports by Item
<seasonally adjusted,
3-month moving averages>



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

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

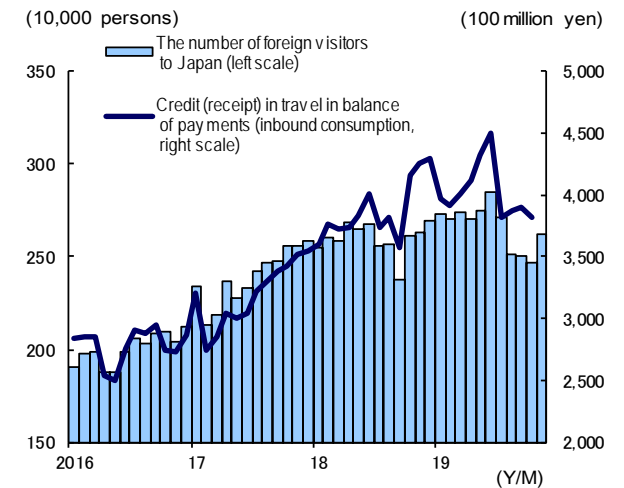
Figure 3-2 Real Exports of Transport Equipment by Destination
<seasonally adjusted,
3-month moving averages>



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

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

Figure 3-3 Receipt in Travel in Balance of Payments
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, Japan National Tourism Organization (JNTO).

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While Corporate Profits Are at a Standstill, Business Fixed Investment Is Projected to Remain on the Rise

◆ Corporate Profits Have Stalled

Corporate profits have been sluggish while remaining at a high level. According to the Financial Statement Statistics of Corporations by Industry quarterly report, current profits for the period from July–September 2019 declined for the second consecutive quarter, down 1.1% from the previous quarter. In the manufacturing sector, against a backdrop of a slowdown in global capital spending, earnings deteriorated among steelmakers, chemical and other materials companies, as well as production machinery and information and communications equipment manufacturers. In the nonmanufacturing sector, profits increased for the retail industry driven by the rush in demand prior to the consumption tax rate hike. However, profits fell in the information and communications industry, which slashed mobile phone charges, and in the hotel and food services industries, which were negatively affected by a decrease in South Korean visitors to Japan.

Corporate profits for the October–December period are expected to fall further

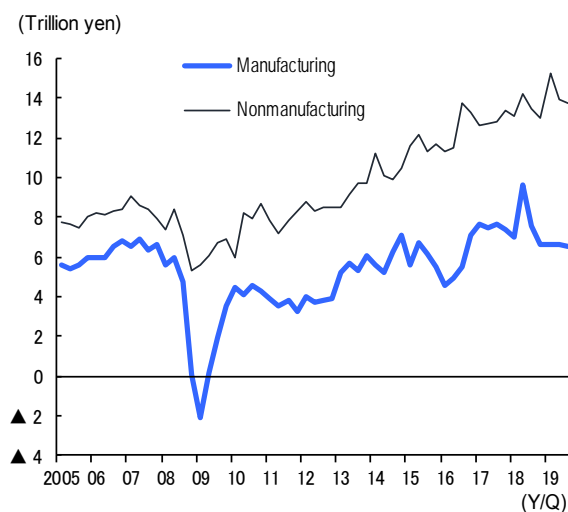
owing to a reactionary decline due to the rush in demand triggered by the consumption tax rate hike as well as sluggish production and sales caused by a series of natural disasters including major typhoons. Corporate profits, however, will likely return to the recovery path as exports subsequently pick up.

◆ Business Fixed Investment Is Expected to Remain on a Rising Trend

On the other hand, capital investments have remained on an increasing trend. Looking at business fixed investments (excluding software investments) for the July–September 2019 period, investments have increased in both the manufacturing and nonmanufacturing industries.

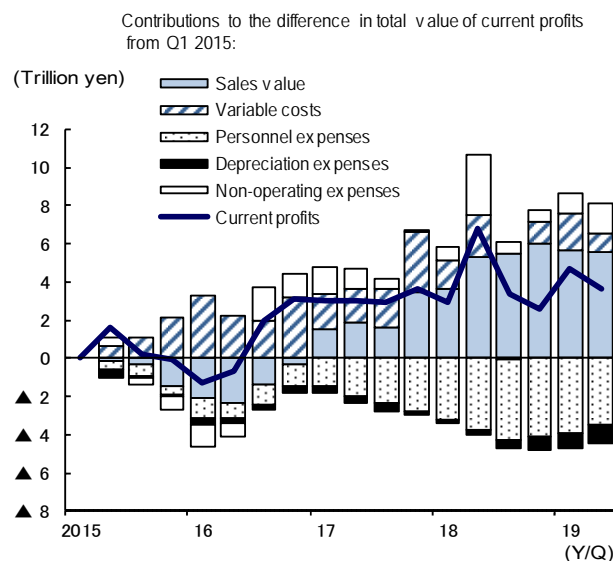
In the future outlook, capital expenditures are forecast to remain on a rising trend, reflecting strong demand for investments for rationalization and labor saving driven by labor shortages as well as investments for maintenance and replacement related to aging facilities.

Figure 4-1 Current Profits of Japanese Corporations by Type <seasonally adjusted>



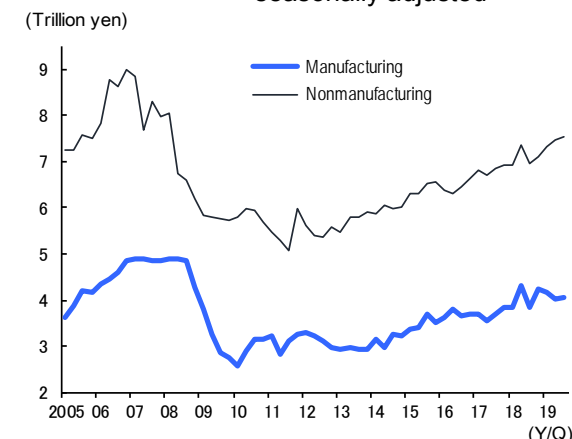
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 4-2 Contributions of Factors to Change in Total Value of Current Profits



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

Figure 4-3 Value of Business Fixed Investment Based on Financial Statements Statistics of Corporations by Industry <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: 1. All industries except for financial services and insurance.
2. Excluding software investment.

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Income Is Expected to Increase Steadily

◆ The Income Situation Continues to Improve

While the pace of growth in the number of workers has declined since the 2018 peak, the rising trend has continued with the number of workers increasing by around 600,000 year-on-year. Although labor demand in the manufacturing sector was somewhat weak against the background of sluggish exports, the number of jobs in the nonmanufacturing sector has continued to expand in industries such as the food services where labor shortages are pronounced. In addition, the number of work hours per employee has been decreasing due to the effect of workstyle reforms among other factors, which has also contributed to boosting the number of workers.

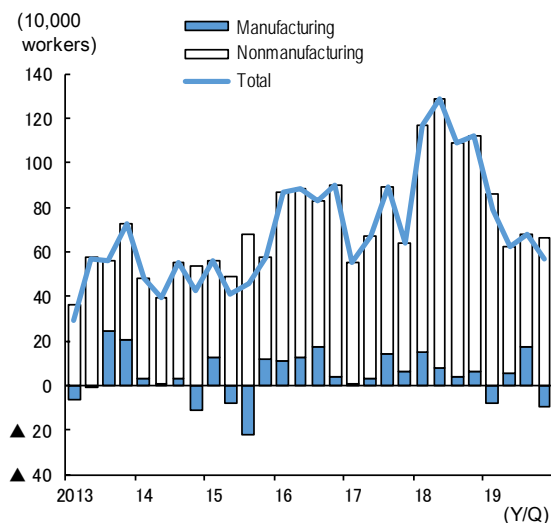
Meanwhile, on the wages front, nominal wages have remained on a rising trend. Excluding the effects of sample changes, the total sum of cash earnings of full-time

workers in October 2019 rose 1.0% from the previous year. Scheduled salaries remain on a rising trend driven by the implementation of pay scale increases, which has contributed to the upward trend in nominal wages.

◆ Compensation for Employees Is Likely to Increase Firmly

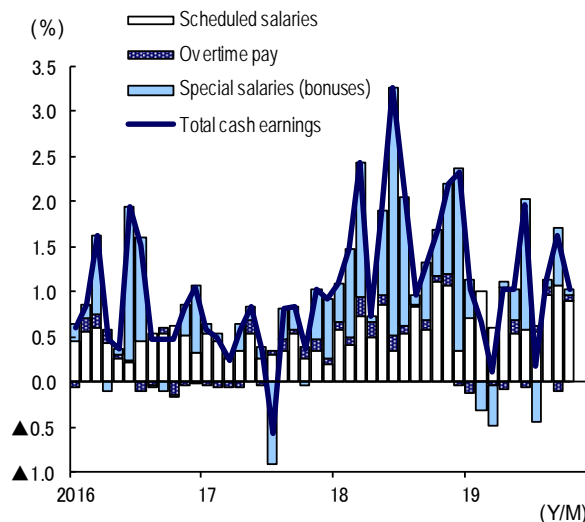
As for future prospects, it is predicted that labor demand will continue to grow moderately. This is because the number of workers will likely continue to increase in the nonmanufacturing sector in which a strong sense of the labor shortage is still being felt and exports are expected to bottom out in the manufacturing sector. Nominal wages will likely remain on a steady rise given the tight labor supply/demand conditions. As a result, growth at around 2% will likely be maintained in nominal compensation for employees.

Figure 5-1 Number of Employees by Type
<difference from a year earlier>



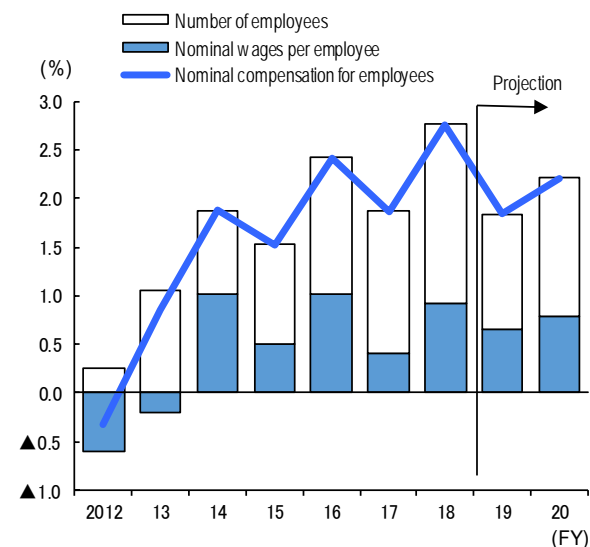
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note: The figure in Q4 2019 is for October-November 2019.

Figure 5-2 Total Cash Earnings of Full-time Workers
<year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labor and Welfare.
Note: The effects of the sample changes in January 2018 and January 2019 were adjusted.

Figure 5-3 Nominal Compensation for Employees
<year-on-year % change>



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

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Private Consumption Expenditure Is Anticipated to Recover Moderately

◆ Prolonged Stagnation in Consumption Will Likely Be Avoided

Consumer spending is expected to return to a moderate upward trend as the reactionary fall to rush demand recedes, although it recently had a downswing due to the impact of the consumption tax rate hike. The scale of rush demand has been only about 40% of the level at the time of the previous tax rate increase in 2014, and there appears to have been no significant preemptive demand.

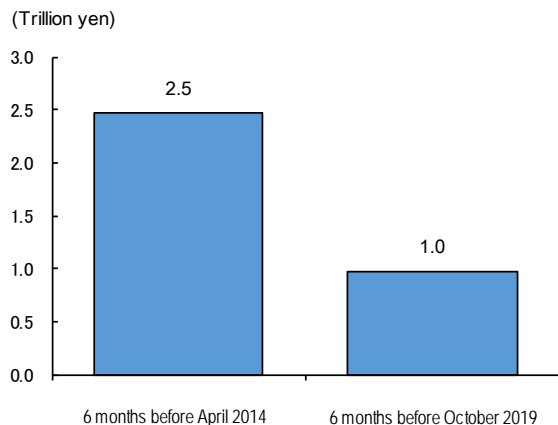
Furthermore, looking at consumer prices after the tax increase, the introduction of a reduced tax rate, the provision of free child education and nursery care, and a decline in energy prices positively contributed to downward pressure on prices. Consequently, inflation has been limited despite the increase in the tax rate. Since real income remains positive even after the tax rate hike, prolonged stagnation in consumption will likely be avoided.

◆ Housing Investment Sees a Decline

The number of housing starts in November decreased for the second consecutive month, down 5.2% month-over-month. The decline was rather large as it reflected a drop in the number of housing starts for rental housing due to stricter screening of loan applications for apartments by financial institutions and the completion of construction of subdivision condominiums.

Regarding future prospects, the number of housing starts for owner-occupied and subdivision detached housing, which had benefited from the rush in demand prior to the consumption tax rate hike, will likely remain on a diminishing trend going forward. Having said that, as the tax rate hike was smaller than the previous one and the government has implemented measures for levelling demand in line with the tax rate hike, the drop in housing starts following the tax rate hike will likely be limited.

Figure 6-1 Rush in Demand during 6 Months prior to the Consumption Tax Rate Rise <JRI estimates>

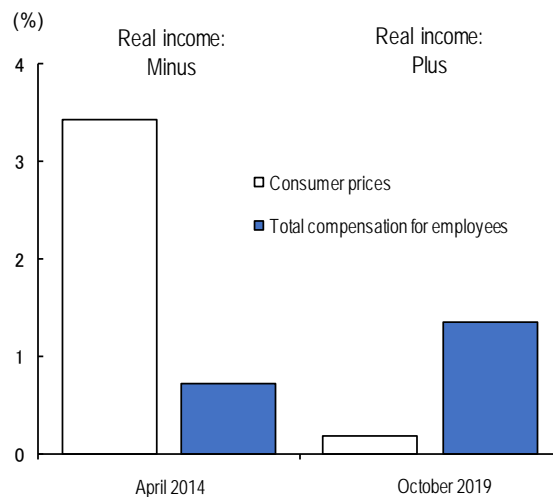


Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Note: The figures are estimated based on the following equation:

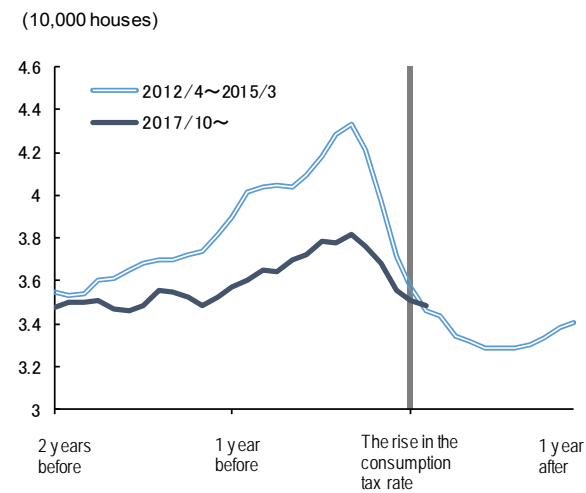
$$\text{Real household consumption} = \text{constant} + \alpha * \text{real compensation for employees} + \beta * \text{consumer confidence index} + \text{rush and reaction dummy variable}$$

Figure 6-2 Nominal Income and Consumer Prices When the Consumption Tax Rates were Raised <year-on-year % change>



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

Figure 6-3 Housing Starts for Owner-occupied and Subdivision Detached Houses <seasonally adjusted, 3-month moving averages>



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

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Topic: The Boosting Effect of Economic Stimulus Measures on the GDP Growth Rate Will Likely Be Limited

◆ Economic Stimulus Package of 26 Trillion Yen Has Been Decided

At a Cabinet meeting on December 5, 2019, the government decided on economic stimulus measures centered on recovery from typhoons and other natural disasters as well as maintaining economic vitality after the Tokyo Olympics. The scale of the economic stimulus package is estimated at 26 trillion yen, and the government estimates that the package will boost real GDP by 1.4%.

However, this economic stimulus package is not expected to boost the growth rate significantly. First, looking at the details of the budget for economic stimulus measures, projects to be allocated in the FY2020 budget have been included in this package to increase the scale. This means that the supplementary budget for FY2019, which can be regarded as an additional expenditure, is 4.3 trillion yen. This is only about the same level as the supplementary budget for FY2018 (3.9 trillion yen for the first and second supplementary budgets), and it cannot be said that

expenditures have been expanded significantly.

◆ The Labor Shortage in the Construction Industry is Expected to Become a Bottleneck

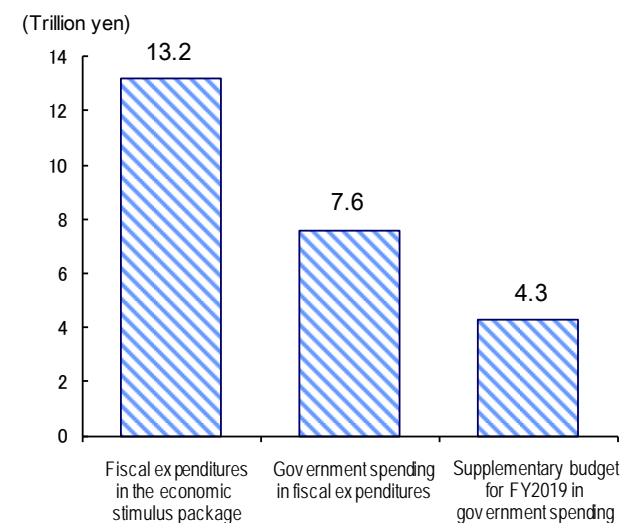
In addition, public investment, which is considered to have a large economic effect, may not be able to be executed as planned due to the labor shortage in the construction industry. The labor shortage in the construction industry is the worst since the bubble economy, and there are many orders that cannot be completed. In addition, public works projects aimed at disaster recovery and disaster prevention are expected to have only a limited economic effect because they are likely to take longer to complete and the budget will not be fully utilized. Based on these factors, the economic stimulus package is anticipated to boost the GDP growth rate by only about 0.3% in FY2020.

Figure 7-1 Outline of the Economic Measures Approved by the Cabinet on December 5

Recovery and reconstruction from disasters and ensuring safety and security (Scale of projects: 7.0 trillion yen)	
Accelerating recovery and reconstruction from natural disasters Strong promotion of disaster prevention and mitigation and strengthening of national resilience	Fiscal expenditure (5.8 trillion yen)
Priority support for those trying to overcome downside risks to the economy (Scale of projects: 7.3 trillion yen)	
Creating an environment for improving productivity of SMEs and small business operators Facilitation of overseas business activities by enterprises Support for the generation who underwent the employment ice age	Fiscal expenditure (3.1 trillion yen)
Investment in the future and maintenance and improvement of economic vitality beyond the Tokyo Olympics and Paralympics (Scale of projects: 11.7 trillion yen)	
Promotion of innovation and social implementation to realize Society 5.0 and the SDGs Seamless support for personal consumption	Fiscal expenditure (4.3 trillion yen)

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

Figure 7-2 Breakdown of the Budget in the Economic Stimulus Package



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

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Prospects for Japan's Economy - Projected Real GDP Change; 0.9% in FY2019 and 1.0% in FY2020

◆ Mild Recovery of the Japanese Economy Will Continue After Overcoming the Effects of the Consumption Tax Rate Hike

(1) Moderate Recovery of the Japanese Economy Is Anticipated

Looking ahead, the Japanese economy is expected to return to a moderate recovery path from the beginning of 2020, although it will temporarily decline due to the effects of the consumption tax rate hike.

Exports will likely benefit from the bottoming out of global IT demand and the easing of the stance of curbing capital investment. Amid the lack of momentum of the global economy on the whole, exports are unlikely to recover strongly but are expected to recover moderately, mainly for electronic parts and capital goods.

Meanwhile, companies are expected to continue to invest actively in information technology and research and development against the backdrop of labor shortages, workstyle reforms and the use of information technology. A halt to the decline in exports will also help boost investment sentiment in the manufacturing sector.

(2) Prolonged Stagnation in Personal Consumption Will Likely Be Avoided

Prolonged stagnation in consumer spending as a result of the consumption tax rate hike will likely be avoided unlike in the case of the previous tax rate increase in 2014. Since the surge in demand ahead of the tax rate hike was limited, there appears to have been no significant preemptive demand. Moreover, the increase in household burdens has been limited, as evidenced by real household income remaining positive even after the tax rate increase. Consumer spending is expected to return to a moderate upward trend as the pullback from the rush in demand comes to a halt.

◆ The Extent of Increase Year-on-year in the Core CPI Will Likely Widen Slightly

(3) In November 2019, the core CPI growth rate was +0.2% year-on-year, virtually flat from the previous month, excluding the impact of the consumption tax rate hike and the provision of free education. This was mainly because the pace of decrease in energy prices accelerated, while the pace of increase in food prices got faster.

As for future prospects, as the extent of decline in energy prices is predicted to narrow, the year-on-year increase rate in the core CPI will likely rise to around the mid-0% level.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of January 6, 2020)

	(seasonally adjusted, annualised % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2019		CY2020				CY2021				CY2022	FY2019	FY2020	FY2021
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)	(Projection)
	(Actual)	(Projection)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	
Real GDP	1.8	▲ 3.7	0.9	2.3	2.0	1.0	1.2	0.5	0.5	0.7	0.7	0.9	1.0	0.8
Private Consumption Expenditure	2.2	▲ 6.9	2.0	2.4	0.0	1.2	1.0	0.8	0.8	0.7	0.7	0.4	0.4	0.8
Housing Investment	6.5	▲ 5.1	▲ 3.8	▲ 2.9	0.0	0.8	0.0	▲ 2.0	▲ 1.2	0.0	0.0	2.3	▲ 1.6	▲ 0.6
Business Fixed Investment	7.3	▲ 3.8	1.6	2.3	2.3	2.1	1.9	1.7	1.7	1.5	1.5	2.3	1.7	1.8
Private Inventories (percentage points contribution)	(▲ 0.7)	(▲ 0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(▲ 0.0)	(0.0)
Government Consumption Expenditure	2.7	1.6	0.0	3.0	4.2	▲ 0.7	1.0	0.5	0.5	0.5	0.5	2.4	1.9	0.7
Public Investment	3.6	2.0	0.0	2.6	5.9	7.7	2.2	▲ 2.9	▲ 3.8	0.0	0.3	3.3	3.5	0.0
Net Exports (percentage points contribution)	(▲ 0.7)	(0.8)	(▲ 0.5)	(▲ 0.1)	(0.5)	(▲ 0.3)	(0.0)	(▲ 0.1)	(▲ 0.1)	(▲ 0.0)	(▲ 0.1)	(▲ 0.3)	(0.0)	(▲ 0.0)
Exports of Goods and Services	▲ 2.5	3.8	▲ 0.8	2.4	3.8	▲ 0.6	1.9	2.0	2.0	1.8	1.6	▲ 0.9	1.5	1.7
Imports of Goods and Services	1.3	▲ 1.0	2.0	2.8	0.8	1.0	1.7	2.4	2.4	1.9	1.9	0.8	1.4	1.9
(Ref.) Domestic Private Demand (percentage points contribution)	(1.8)	(▲ 4.7)	(1.4)	(1.6)	(0.4)	(1.0)	(0.9)	(0.7)	(0.7)	(0.6)	(0.6)	(0.6)	(0.4)	(0.7)
(Ref.) Public Demand (percentage points contribution)	(0.7)	(0.4)	(0.0)	(0.8)	(1.2)	(0.2)	(0.3)	(▲ 0.0)	(▲ 0.1)	(0.1)	(0.1)	(0.6)	(0.6)	(0.1)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
Nominal GDP	2.3	2.4	1.3	1.3	1.3	1.7	2.0	1.6	1.3	1.2	1.1	1.8	1.6	1.3
GDP deflator	0.6	1.7	1.1	1.0	1.0	0.2	0.3	0.5	0.5	0.5	0.5	1.0	0.6	0.5
Consumer Price Index (excluding fresh food)	0.5	0.6	0.8	0.7	0.9	0.6	0.6	0.8	0.8	0.8	0.9	0.7	0.7	0.8
(excluding fresh food, consumption tax, education free of charge)	0.5	0.3	0.4	0.4	0.6	0.7	0.7	0.8	0.8	0.8	0.9	0.5	0.6	0.8
Unemployment Rate (%)	2.3	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.1	2.1	2.1	2.3	2.2	2.1
Exchange Rates (JY/US\$)	107	109	109	110	110	109	108	108	108	108	107	109	109	108
Import Price of Crude Oil (US\$/barrel)	66	65	66	67	68	68	68	68	68	68	68	67	68	68

Source: The Cabinet Office; The Ministry of Internal Affairs and Communications; The Ministry of Economy, Trade and Industry; The Ministry of Finance.

The projection figures are based on those of The Japan Research Institute, Ltd.

Note : "▲" indicates minus.