

Monthly Report of Prospects for Japan's Economy

March 2020

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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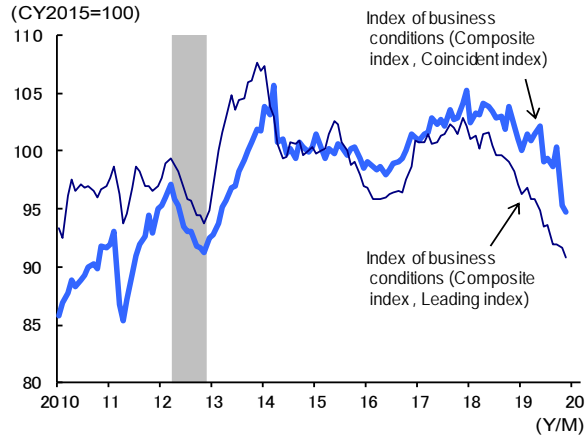
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The General Situation of Japan's Economy – A Sense of Standstill Is Felt in Economic Activity

Figure 1-1 Economic Activity

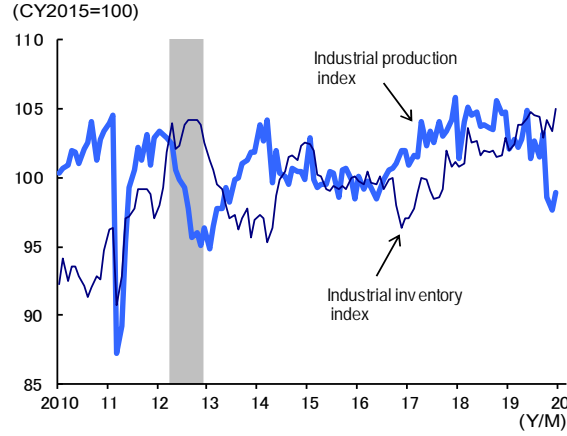
Indices of business conditions remained on a declining trend both in terms of the CI coincident index and the CI leading index.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

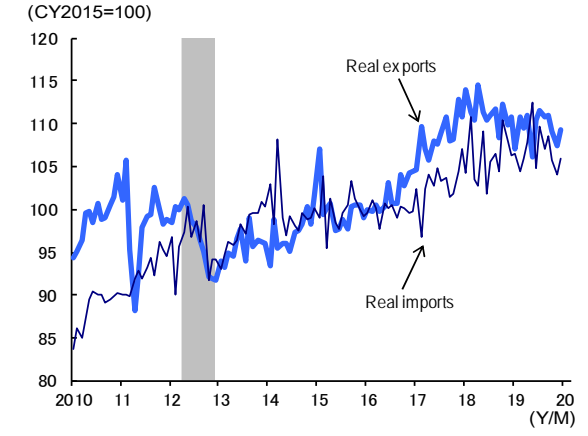
Industrial production index rose for the first time in three months mainly for capital goods, as a result of the recovery in production following natural disasters.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

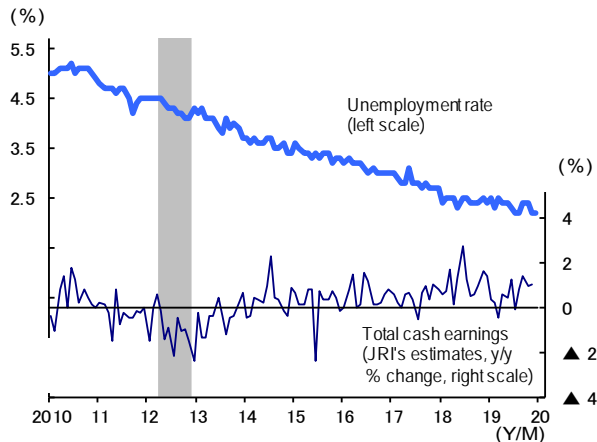
Exports, mainly to the United States, remained sluggish. Imports increased, particularly of mobile phones.



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.

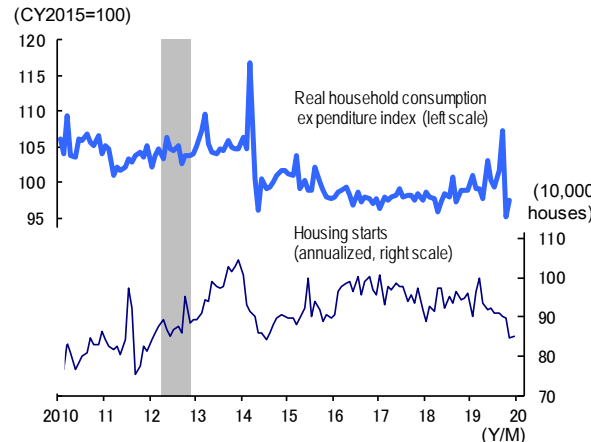


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

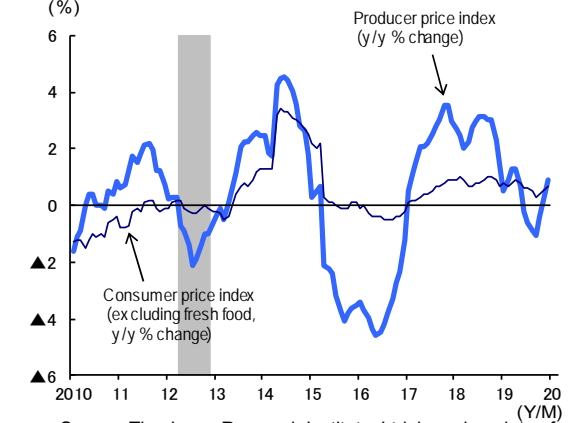
Real household consumption rebounded slightly following a significant decline immediately after the tax hike. Housing starts saw a decline, mainly for owner-occupied housing.



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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Domestic Demand Picked up, While Overseas Demand Remained Sluggish

◆ Exports Continued to Stagnate

Real exports remained stagnant. While exports to China continued to pick up mainly for semiconductor manufacturing equipment, exports of automobiles to the United States and general machinery to Europe significantly declined.

◆ Industrial Production Saw a Small Rebound

The industrial production index for December rose for the first time in three months, up 1.2% from the previous month. Production substantially increased particularly in the production machinery industry as a result of the recovery in production following the suspension of production associated with the typhoons. Looking at future production plans, industrial production is forecast to significantly increase by 3.5% month-over-month in January and by 4.1% month-over-month in February. However, the industrial production index may be revised downward amid increasing concerns over the effects of the novel coronavirus.

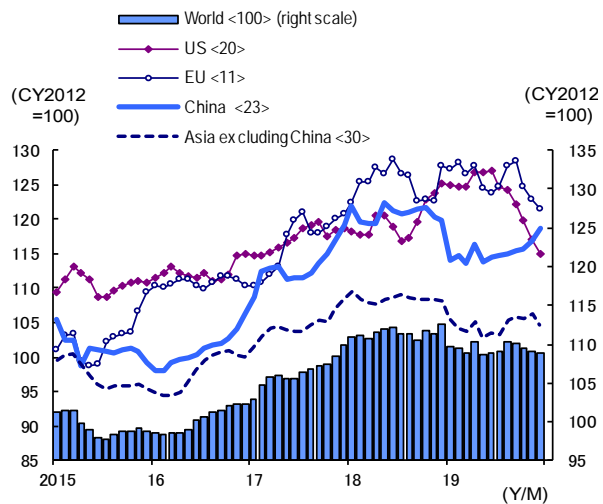
◆ Public Investment Remained Firm

Public investment remained on a rising trend as public works projects, which had accumulated prior to the consumption tax hike, have been implemented in earnest. The contract amount of public works projects, which serves as a leading indicator, is expected to increase again following the passage of the fiscal 2019 supplementary budget, although the increase has recently slowed.

◆ Signs of Recovery Have Been Witnessed in the Household Sector

Employment and income conditions continued to improve. The unemployment rate in December stood at 2.2%, hovering around its lowest level since 1992. The active job opening-to-applicants ratio was 1.57 times, indicating that labor supply/demand conditions remain tight. Personal consumption also picked up from a significant decline due to the effects of the consumption tax rate hike and the typhoons as demonstrated by the real consumption activity index in November, which rose 2.7% month-over-month.

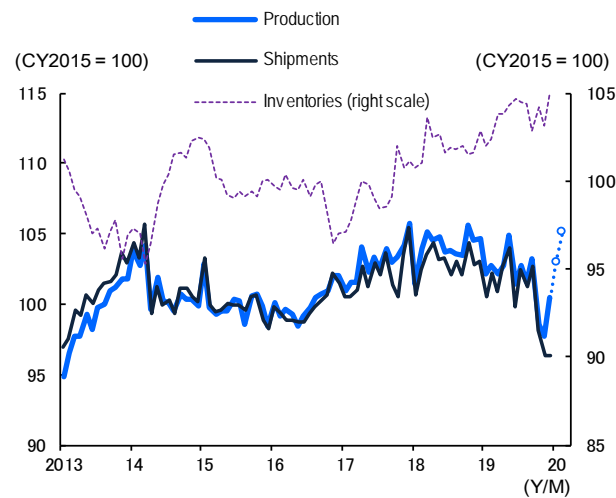
Figure 2-1 Real Exports by Destination
<seasonally adjusted,
3-month moving averages>



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

Note: 1. Figures in the angled brackets show the shares in total nominal exports in CY2018.
2. China including Hong Kong.

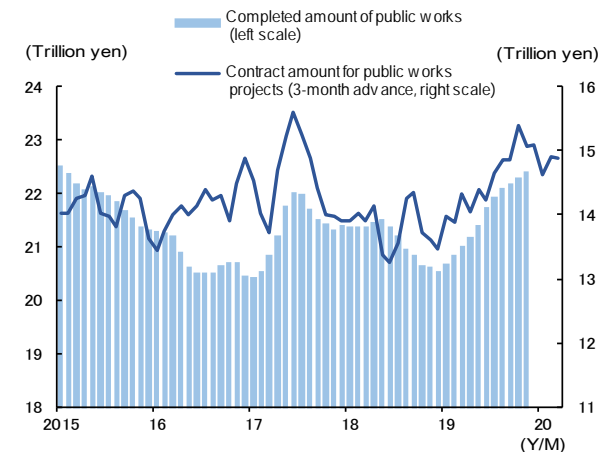
Figure 2-2 Industrial Production Index
<seasonally adjusted>



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 January and February 2020 based on the production forecast index.

Figure 2-3 Completed and Contract Amounts
of Public Works
<annualized, seasonally adjusted,
3-month moving averages>



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

Note: Non-dwelling.

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Exports of Both Goods and Services Remain Lackluster

◆ Exports of Goods Continued to Stagnate

Exports of goods have been sluggish since the beginning of 2019. As the global semiconductor market bottomed out, exports of electronic parts and devices increased, while exports of transport equipment fell sharply. Looking at exports of transport equipment by region, exports to the United States declined significantly against the backdrop of the shift toward local production of finished vehicles which had previously been exported from Japan, and exports to Asia excluding China also remained sluggish reflecting stagnant sales in the local markets.

Regarding future prospects, 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, in addition to a recovery in semiconductor demand. As for the future outlook, exports will likely pick up moderately, mainly for

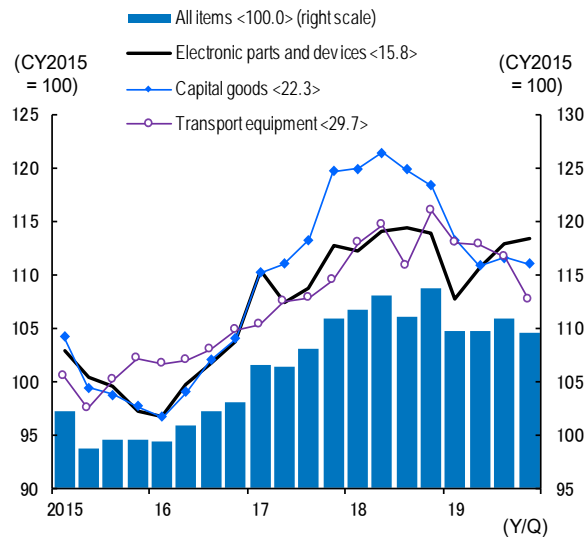
electronic components and capital goods.

◆ Demand Related to Inbound Tourism Declined

The number of tourists that visited Japan in December 2019 decreased by 1.4% from the previous month as the number of South Korean tourists visiting Japan continued to decline.

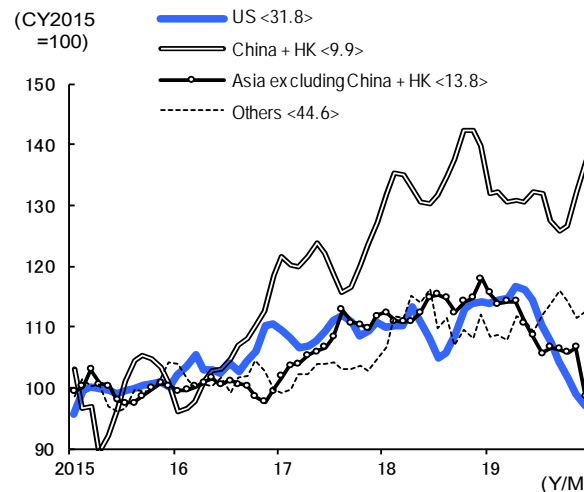
As for the future outlook, in addition to the prolonged slump in the number of South Korean visitors to Japan, the outbreak of the novel coronavirus is expected to apply downward pressure on consumption related to inbound tourism. When SARS was rampant in 2003, the number of tourists visiting Japan from China, Hong Kong and Taiwan, which had been at the center of the spread of the disease, temporarily halved. If the number of Chinese visitors to Japan were to drop by half at this juncture, the total consumption related to inbound in Japan could be reduced by approximately 20%.

Figure 3-1 Real Exports by Item
<seasonally adjusted>



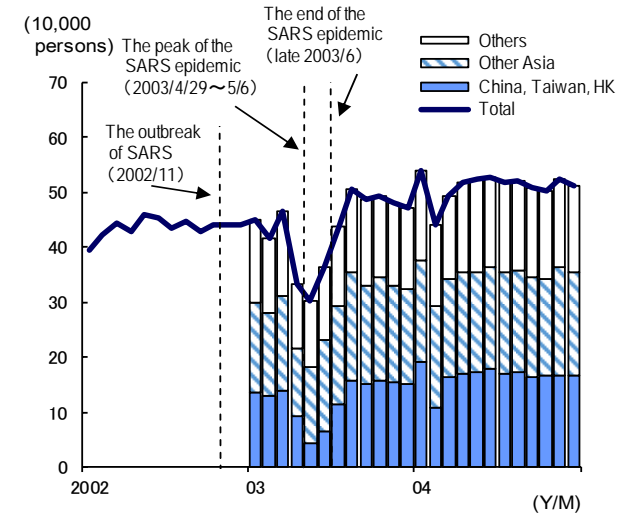
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2018.

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 of transport equipment in CY2018.

Figure 3-3 Number of Foreign Visitors to Japan during SARS Outbreak
<seasonally adjusted>



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

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

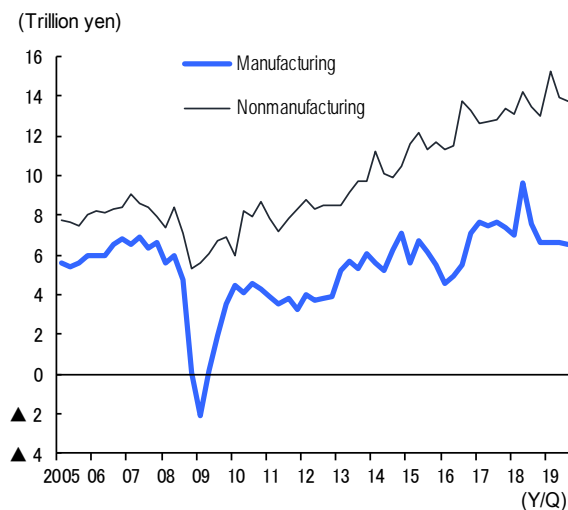
owing to a reactionary decline due to the rush in demand triggered by the consumption tax rate hike as well as sluggish production and sales caused by a series of natural disasters including major typhoons. Corporate profits, however, will likely return to the recovery path as the effects of the tax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

◆ 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.

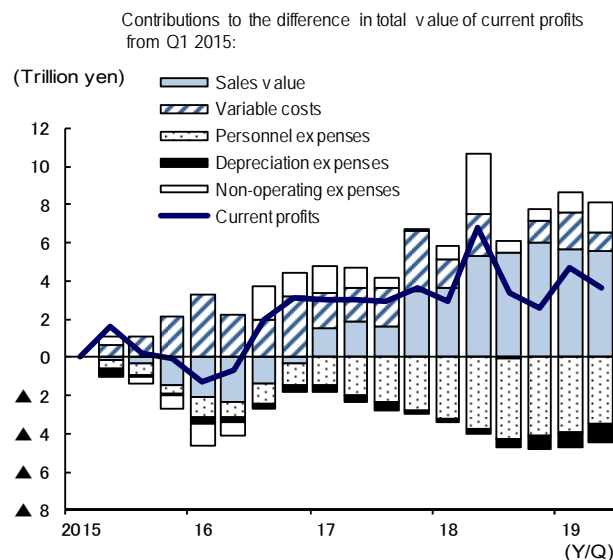
In the future outlook, capital expenditures are forecast to remain on a rising trend, reflecting strong demand for investments for rationalization and labor saving driven by labor shortages as well as investments for maintenance and replacement related to aging facilities.

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



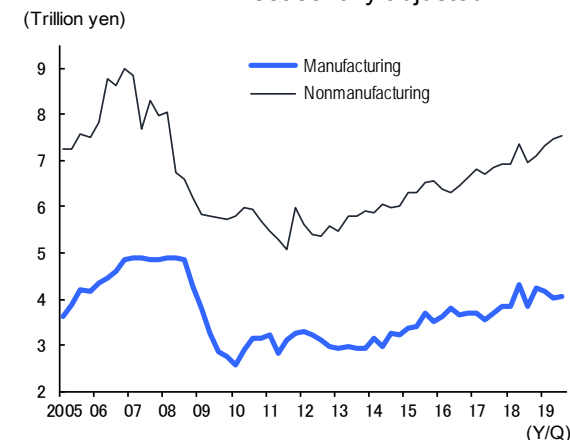
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

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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Personal Spending Will Recover Moderately After Overcoming the Effects of the Consumption Tax Rate Hike

◆ Private Consumption Will Pick up Gradually Despite the Deterioration Immediately After the Tax Rate Hike

In October 2019, immediately after the consumption tax rate hike, retail sales plummeted due to a backlash from the rush in demand as well as downward pressure from factors caused by typhoons such as temporary store closures and supply shortages as a result of plant shutdowns. However, retail sales have been recovering slightly since November.

By industry, automobile sales recovered to the previous year's level (pre-tax hike level) in line with the resumption of production at disaster-affected plants. As for sales at department stores and sales of home appliances, while sluggish sales of air conditioners and winter clothing due to the warm winter have been weighing on private consumption, the contraction in sales has been narrowing compared with that in October.

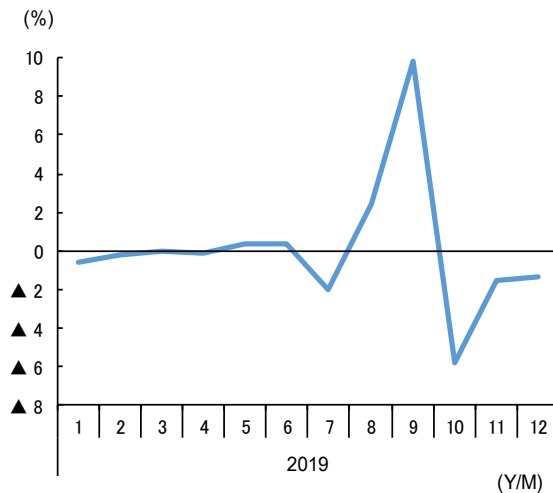
◆ Personal Spending Will Rebound Moderately After Overcoming the

Effects of the Consumption Tax Rate Hike

Regarding future prospects, consumer spending is expected to return to a moderate upward trend as the reactionary fall to rush demand and the negative effects of the warm winter recede.

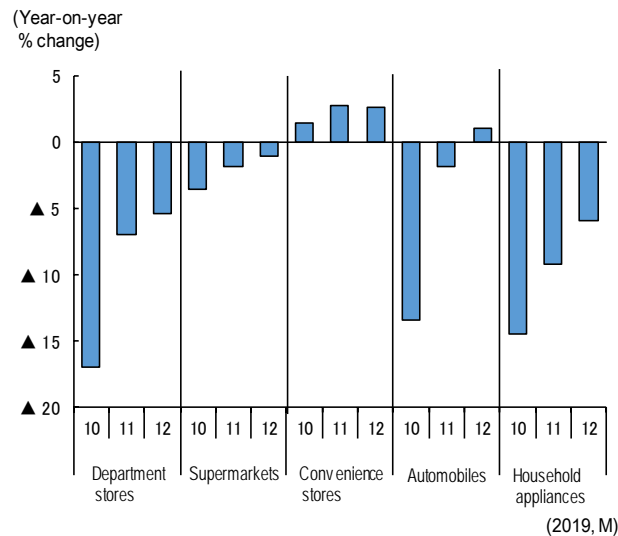
The scale of rush demand was only about 40% of the level before the previous tax rate increase in 2014, and there appears to have been no significant preemptive demand. Therefore, the pullback from the rush in demand will likely not be prolonged. Furthermore, looking at consumer prices after the tax increase, inflation has been limited despite the increase in the tax rate, thanks to the measures to mitigate burdens including the introduction of a reduced tax rate and the provision of free child education and nursery care. On the back of labor shortages, nominal income has also remained on a rising trend. Since real income growth remains positive even after the tax rate hike, prolonged stagnation in consumption will likely be avoided.

Figure 5-1 Retail Sales Value <seasonally adjusted, year-on-year % change>



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

Figure 5-2 Retail Sales Value by Type after Consumption Tax Hike <seasonally adjusted, year-on-year % change>



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

Figure 5-3 Contributions to Real Income after Consumption Tax Hike <year-on-year % change>



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

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Topic: Employment in the Manufacturing Sector Has Been Strong Despite Stagnant Production

◆ An Increase in Employment Has Been Driven by Technical and Production Process Workers

Since the beginning of 2019, the number of employees in Japan's manufacturing industry has been on an increasing trend, although production activity has declined.

Looking at the increase and decrease in the number of workers by occupation in the first half of fiscal 2019, the increase was led by professional and technical occupations. Companies, which have been faced with the need to respond to new technologies such as AI and IoT, are making every effort to secure digital technology professionals without being influenced by a temporary slowdown in production.

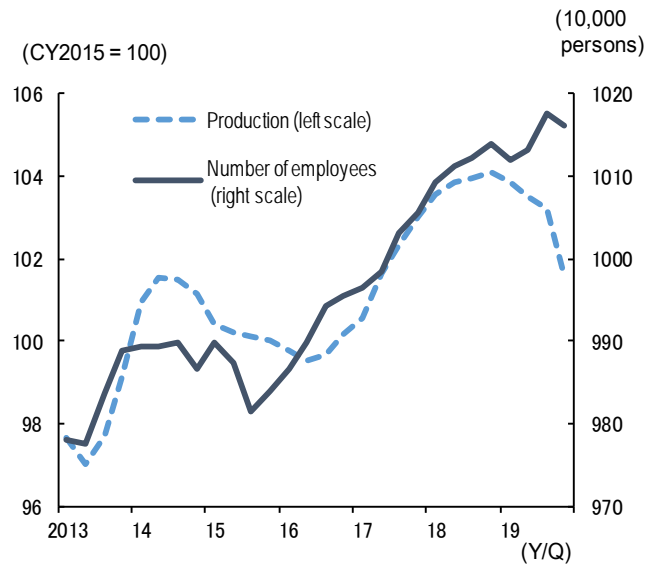
In addition, the number of workers engaged in the production process increased in spite of the fact that they are highly linked to production. As the background for this, it is possible to point out the reduction of working hours through reform of working styles. Breaking down the total labor input of production process workers into the

number of working hours per worker and the number of workers, the number of working hours in the first half of fiscal 2019 decreased at a pace exceeding the decline in production. Many companies apparently sought to secure additional workers to maintain production levels.

◆ Job Growth Is Expected to Continue in the Future

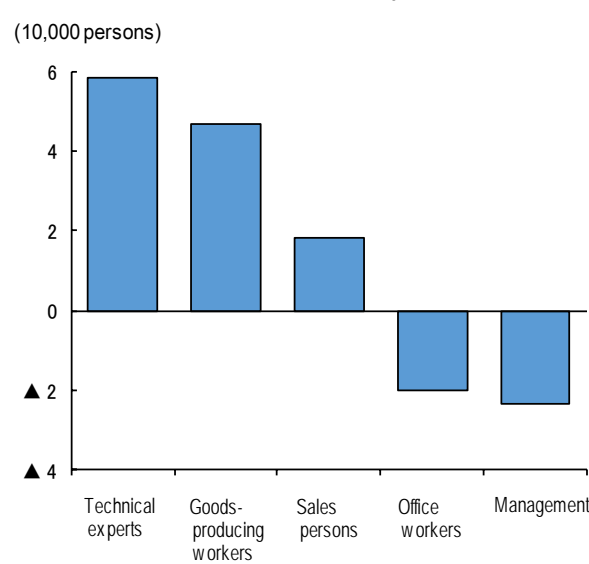
Looking ahead, while there is a possibility that temporary employment adjustments will occur in industries in which exports have been sluggish for a long time, it is unlikely that employment in the manufacturing industry will collapse significantly because there is a strong need for experts in digitization. In addition, the application of the overtime ceiling to small and medium-sized enterprises (SMEs) in April 2020 is expected to boost the number of employees. Since the proportion of workers who work long hours at small and medium-sized manufacturers is high at 8.0%, they will likely be required to increase staff more than large manufacturers.

Figure 6-1 Production and Number of Employees in the Manufacturing Industry <4-quarter moving averages>



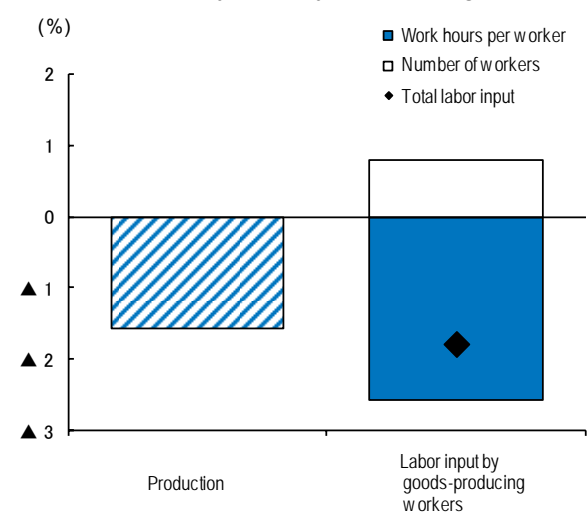
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Ministry of Economy, Trade and Industry.

Figure 6-2 Change in Number of Employees by Type <the first half of FY2019, difference from a year earlier>



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

Figure 6-3 Change in Production and Labor Input <the first half of FY2019, year-on-year % change>



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

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Prospects for Japan's Economy - Projected Real GDP Change; 0.4% in FY2019 and 0.8% in FY2020

◆ While the Japanese Economy Is Expected to Return to a Recovery Path, Close Attention Must Be Paid to the Effects of the Novel Coronavirus

(1) Japan's real GDP for the October-December 2019 period decreased by 6.3% on an annualized quarter-on-quarter change basis (down 1.6% from the preceding quarter), showing substantial negative growth since the time of the previous consumption tax rate hike in 2014 (April-June 2014 period: down 7.4% on an annualized quarter-on-quarter change basis). Consumer spending fell 11.0% on the same basis, reflecting a sharp decline in domestic demand, and it has become clearer that the Japanese economy is in a downswing due to the consumption tax rate hike.

(2) The revised prospects bolster the view that the Japanese economy will likely return to a recovery path, underpinned by a rebound in global IT demand, aggressive capital investment by companies due to labor shortages and the government's economic stimulus measures. However, the growth projections for FY2019 and FY2020 have been revised downward to +0.4% and +0.8%, respectively (compared to the previous projections of +0.9% and +1.0%, respectively), in light of the greater-than-expected decline in personal consumption after the tax rate hike and the negative effects from the spread of the novel coronavirus.

(3) The decline in personal consumption in the October-December 2019 period was partly due to a combination of negative factors such as large typhoons in October and a warm winter, in addition to the effects of the consumption tax rate hike. At present, there are signs of recovery, and according to a survey by business watchers in January, some comments pointed out that consumption has been recovering compared to the decline seen immediately after the tax rate hike. Personal consumption is expected to return to an upward trend as the reactionary decline due to the rush demand comes to an end, given the fact that real household income has remained above the level of the previous year, partly due to the introduction of a reduced tax rate. However, the timing of the recovery of personal consumption to the level before the tax rate hike is likely to be later than previously assumed, as it takes time to dispel the burden of taxes on households.

(4) The spread of the novel coronavirus is another factor pushing down the growth rate. As many companies are considering alternative production of intermediate goods produced in China at other production bases in Japan and other Asian countries, we have concluded that the negative impact on domestic production activities is limited at present. The adverse effects on the Japanese economy are expected to be mainly due to a decrease in demand related to inbound tourism. However, if the spread of the disease accelerates in Japan, household consumption and corporate production will become severely restricted and the Japanese economy will inevitably slow down considerably.

◆ The Extent of Increase Year-on-year in the Core CPI Widened Slightly

(5) The rate of year-on-year increase in the core CPI which excludes fresh food was +0.4% in December 2019, excluding the impact of the consumption tax rate hike and the provision of free child education and nursery care, slightly up from +0.2% in the previous month. This was mainly because the pace of fall in energy prices slowed down due to the rise in the price of crude oil.

As for future prospects, reflecting upward pressure from the supply-demand side stemming from mild economic recovery, the rate of year-on-year increase in the core CPI on the same basis will likely continue to be around the mid-0% level.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of February 17, 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)	(Actual)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	0.5	▲ 6.3	1.8	2.4	2.3	1.2	1.1	0.5	0.4	0.7	0.7	0.4	0.8	0.8
Private Consumption Expenditure	1.9	▲ 11.0	2.6	2.8	0.9	1.8	0.9	0.6	0.6	0.7	0.7	▲ 0.3	0.3	0.8
Housing Investment	5.0	▲ 10.4	▲ 2.6	0.0	0.2	0.8	0.0	▲ 2.0	▲ 1.2	0.0	0.0	1.1	▲ 1.4	▲ 0.6
Business Fixed Investment	1.9	▲ 14.1	8.9	3.0	2.5	2.1	1.9	1.7	1.7	1.5	1.5	0.4	1.5	1.8
Private Inventories (percentage points contribution)	(▲ 0.8)	(0.5)	(0.2)	(▲ 0.3)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.0)	(0.0)
Government Consumption Expenditure	3.0	0.9	0.2	2.6	4.0	▲ 0.7	1.0	0.5	0.5	0.5	0.5	2.4	1.7	0.7
Public Investment	5.1	4.6	0.0	2.0	3.0	6.4	2.2	▲ 2.0	▲ 3.6	0.0	0.3	4.0	2.9	0.0
Net Exports (percentage points contribution)	(▲ 1.0)	(1.9)	(▲ 1.1)	(0.1)	(0.4)	(▲ 0.3)	(0.0)	(▲ 0.1)	(▲ 0.1)	(▲ 0.0)	(▲ 0.0)	(▲ 0.2)	(0.0)	(▲ 0.0)
Exports of Goods and Services	▲ 2.8	▲ 0.4	▲ 2.0	4.2	3.9	▲ 0.6	1.9	2.0	2.0	1.8	1.6	▲ 1.5	1.2	1.7
Imports of Goods and Services	2.8	▲ 10.1	4.5	3.8	1.5	1.0	1.7	2.4	2.4	1.9	1.9	▲ 0.2	1.1	1.9
(Ref.) Domestic Private Demand (percentage points contribution)	(0.7)	(▲ 8.7)	(2.9)	(1.7)	(0.9)	(1.3)	(0.8)	(0.6)	(0.6)	(0.6)	(0.6)	(▲ 0.0)	(0.3)	(0.7)
(Ref.) Public Demand (percentage points contribution)	(0.8)	(0.4)	(0.0)	(0.6)	(1.0)	(0.2)	(0.3)	(▲ 0.0)	(▲ 0.1)	(0.1)	(0.1)	(0.7)	(0.5)	(0.1)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
Nominal GDP	2.3	0.9	0.3	0.4	0.6	2.2	2.1	1.7	1.3	1.1	1.1	1.2	1.3	1.3
GDP deflator	0.6	1.3	0.9	0.8	0.6	0.3	0.4	0.4	0.5	0.5	0.5	0.8	0.5	0.5
Consumer Price Index (excluding fresh food)	0.5	0.6	0.8	0.8	1.0	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	0.5	0.7	0.7	0.7	0.8	0.8	0.8	0.9	0.5	0.6	0.8
Unemployment Rate (%)	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.1	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	66	66	65	68	68	68	68	68	68	68	67	67	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.