

Monthly Report of Prospects for Japan's Economy

December 2017

Macro Economic Research Centre
Economics Department



The Japan Research Institute, Limited

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

This report is the revised English version of the November 2017 issue of the original Japanese version.

Disclaimer:

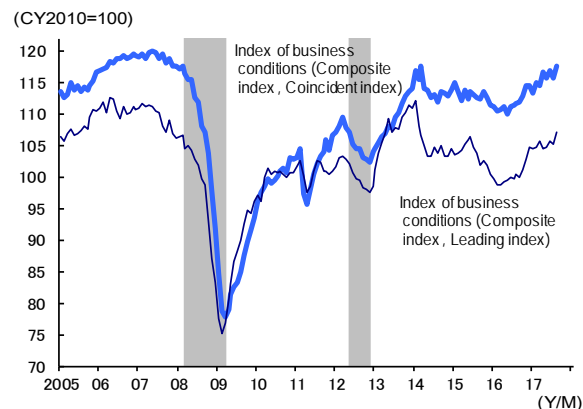
This report is intended solely for informational purposes and should not be interpreted as an inducement to trade in any way.

All information in this report is provided "as is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied, including, but not limited to warranties of performance, merchantability and fitness for a particular purpose. In no event will JRI, its officers or employees be liable to you or anyone else for any decision made or action taken in reliance on the information in this report or for any damages, even if we are advised of the possibility of such damages. JRI reserves the right to suspend operation of, or change the contents of, the report at any time without prior notification. JRI is not obliged to alter or update the information in the report, including without limitation any projection or other forward looking statement contained therein.

The general situation of Japan's economy – Economic activity continues its mild recovery trend

Figure 1-1 Economic Activity

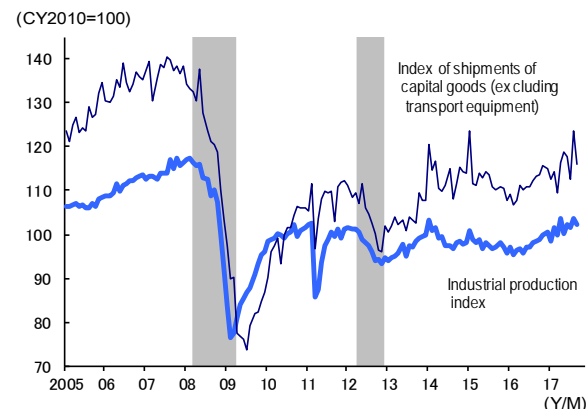
The leading index climbed to the highest level since February 2014. The coincident index topped the level in March 2014.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

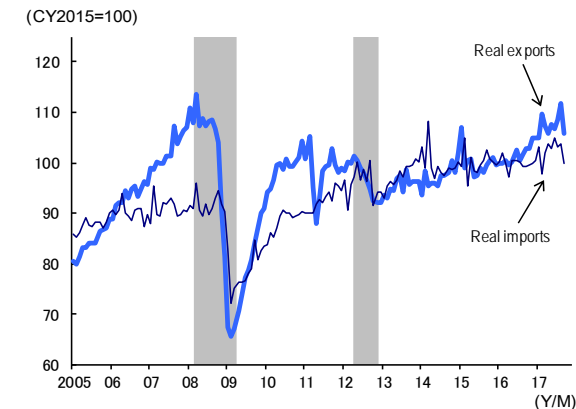
Both the production index and the index of shipments of capital goods have maintained the increasing trend on the whole, albeit while moving up and down.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

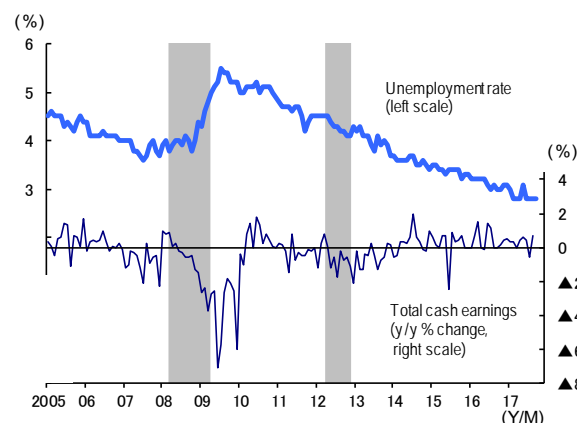
The rising pace of exports to the US paused. Imports decreased for the first time in 2 months.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate stays at a low level. Total cash earnings continue a slight rise year-on-year on the whole.

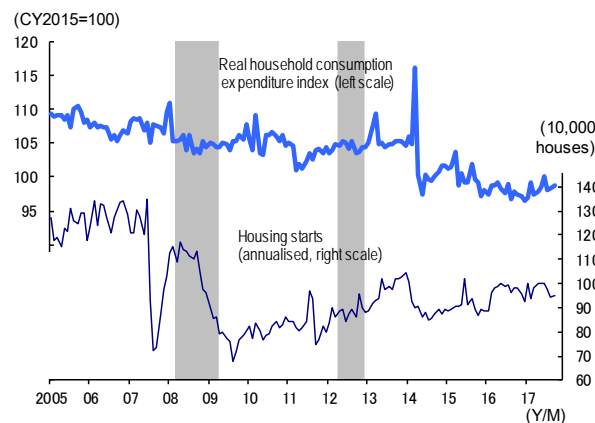


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

* The shaded area indicates the phase of recession.

Figure 1-5 The Household Sector

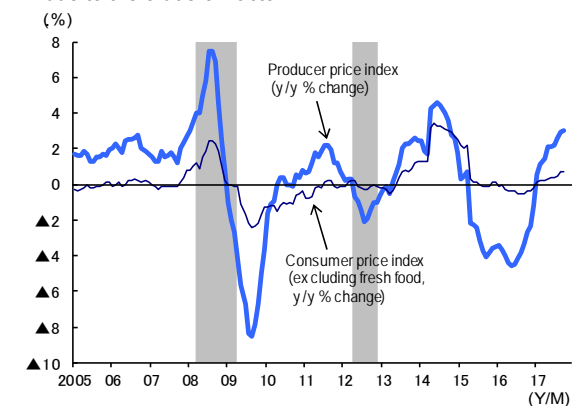
Household consumption expenditure is on a mild trend of recovery. Housing starts stay firm.



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

Figure 1-6 Prices

Producer prices rose year-on-year for 9 months in a row. Core consumer prices picked up modestly, due to the crude oil factor.



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

Monthly Report of Prospects for Japan's Economy December 2017
The Japan Research Institute, Limited

Production increases in the corporate sector, as the household sector also recovers mildly

◆ Economic activity has picked up mildly on the whole

Japan's economic activity continues to be on a mild recovery trend.

Japan's real GDP in the July-September period this year grew by 1.4 per cent on an annualised quarter-on-quarter change basis (national accounts, the first preliminary estimates), a positive figure for 7 quarters in a row. Real net exports contributed considerably to the total growth.

Meanwhile, based on the Economy Watchers Survey, the DIs for current economic conditions for household activity-related industries have risen, led by retailing and food services. Also, the DIs for corporate activity-related industries have stayed over a diverging level of 50.

◆ In the corporate sector, production maintains its rising trend

As for business activity, the industrial production index fell in September. Yet, besides the decline in electronic parts for smartphones, the decline had an aspect of reactionary fall to the rapid rise in August, when general, production, and industrial

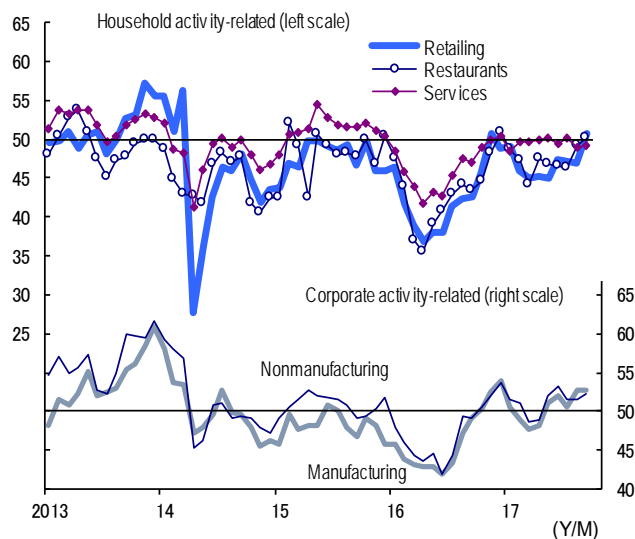
machinery, etc., increased noticeably. Taking into account the production forecast index which shows a significant 2.4 per cent increase in October, it is estimated the recovery trend will not have wobbled. Concerning automobile production, the stoppage of shipments due to the problem of improper pre-shipment inspections in a large manufacturer could lead to a downswing.

Regarding overseas demand, real exports slowed of late after having climbed to the highest level since March 2008, mainly because exports of automobiles to the US decreased due to the negative effect of severe hurricanes.

◆ The household sector continues to recover mildly

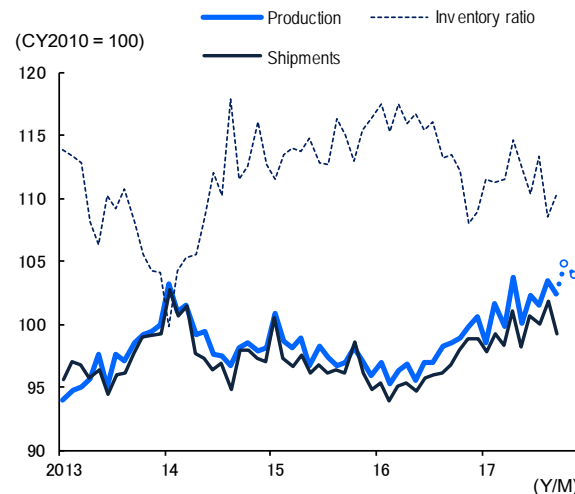
Sales value in department stores and supermarkets increased by 1.9 per cent year-on-year in September, having accelerated from the previous month. One of the main reasons was good sales of precious metals and jewels in department stores, due to heightened willingness to purchase by wealthy consumers, partly affected by stock price rises, in addition to buoyant inbound demand.

Figure 2-1 The Economy Watchers Survey by Type and Industry
<DIs for current economic conditions>



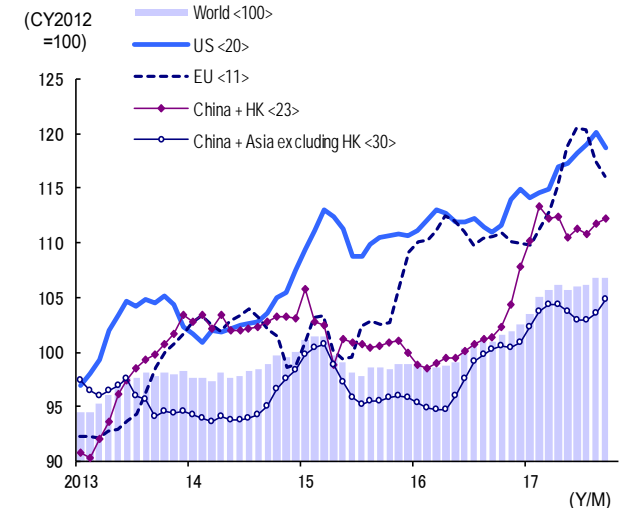
Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.

Figure 2-2 Indices of Industrial Production <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Economy, Trade and Industry.
Note: The latest two figures in production are based on the production forecast index.

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



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angle brackets show the shares in FY2016.

Monthly Report of Prospects for Japan's Economy December 2017
The Japan Research Institute, Limited

Exports are likely to pick up moderately

◆ Inbound demand from foreign tourists to Japan goes on picking up

As for inbound demand, owing to the weak yen environments, the number of foreign tourists to Japan climbed by about 20 per cent on a year earlier. Also, the value spent per tourist turned to a year-on-year increase.

Looking ahead, inbound demand will likely stay firm, taking into account factors such as 1) income among people in Asian emerging countries continues to increase, and 2) necessary environments for foreign tourists such as accommodations are likely to improve further in Japan, although supply restraint shown in the high rate of operation in hotels is seen currently.

◆ Japan's exports of goods will likely continue to rise, albeit moderately

Then, observing overseas demand more widely, Japan's real exports of goods declined by 5.4 per cent month-on-month in September. The main reason for this was a visible fall in exports of transport equipment to the US due to the negative effect of severe hurricanes during that period. However, it is expected that exports of

automobiles to the US will recover soon, because of a rapid rebound in sales after hurricanes including replacement and continued firm sales in Japanese automobiles.

Real exports of electronic parts and devices will also likely have turned to a solid trend again after a slowdown, and will continue the firm trajectory. Also in the medium and long term, it is predicted that exports of electronic parts and devices will be on a firm rising trend, driven by an expanding demand due to a further spread of such uses as cloud computing services, IoT(Internet of Things), and an incorporation into automobiles.

Yet, the pace of the pickup in exports will likely remain moderate. This tendency is due to the fact that more Japanese enterprises have come to meet the increased overseas demand for their products by expanding production in their overseas facilities, as the shift of production facilities to overseas sites has advanced.

Figure 3-1 Value Spent in Japan per Foreign Tourist
<year-on-year % change>

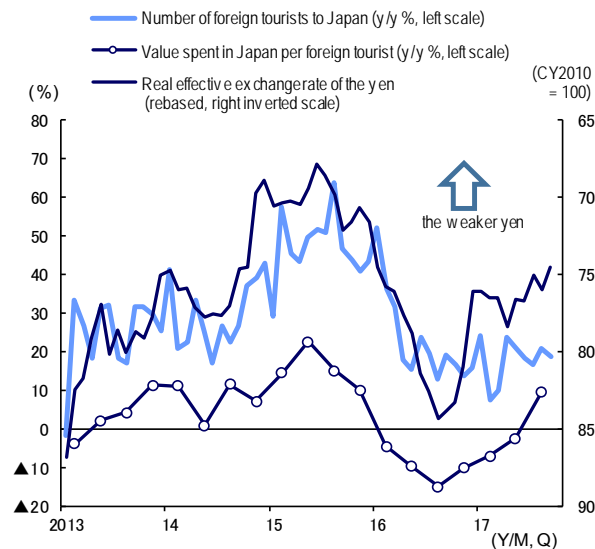


Figure 3-2 Value of Worldwide Shipments of Semiconductors and Japan's Real Exports of Electronic Devices

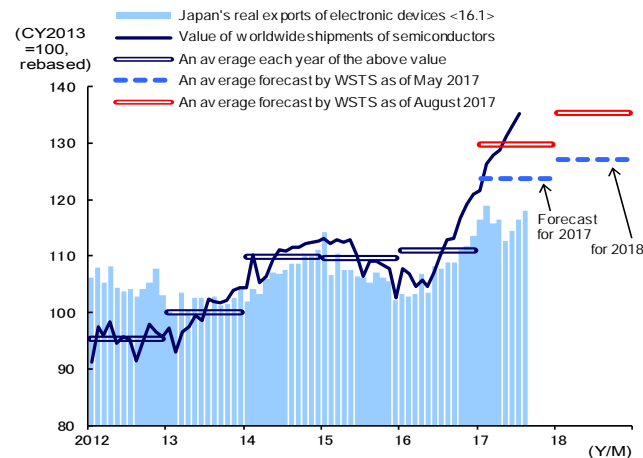
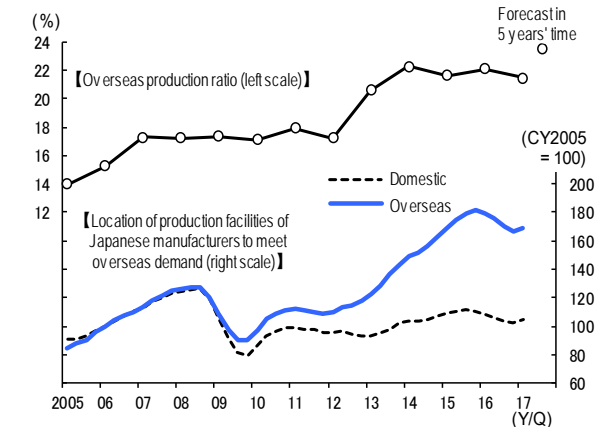


Figure 3-3 Location of Production Facilities of Japanese Manufacturers to Meet Overseas Demand



With corporate profits continuing to be buoyant, business fixed investment will likely pick up

◆ Corporate profits continue to improve

Based on the Tankan September 2017 Survey, planned current profits in Japanese enterprises are predicted to be revised upwards on an aggregate basis, as the actual exchange rate of the yen against the US dollar has been weaker than had been assumed by the enterprises.

In addition to the weaker yen and an increase in exports, the fact that the power of Japanese enterprises making profits from overseas activity has strengthened has also contributed to buoyant profits, as they have expanded their overseas facilities further. The heightened capability of gaining profits overseas is shown in the example that the amount of receipt of royalties arising from intellectual property rights, which is sent by overseas subsidiaries, has increased.

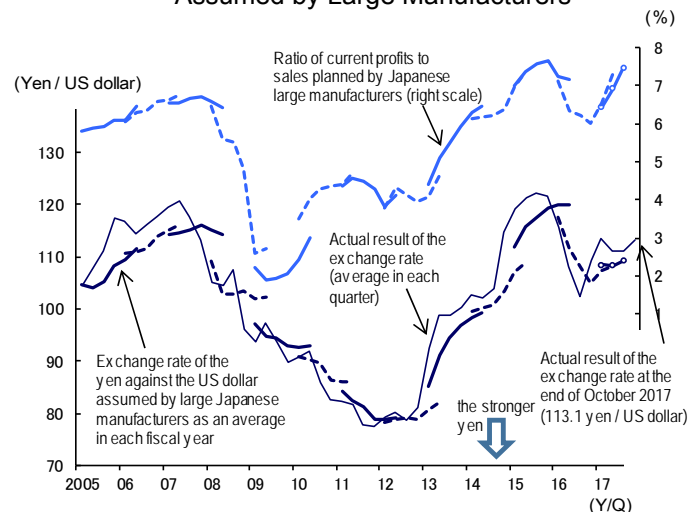
This favourable trend in corporate profits will likely continue, if there are no events such as the exchange rate of the yen surging suddenly due to rapidly heightened tensions with the DPRK.

◆ Business fixed investment will likely pick up

As for business fixed investment, attitudes of enterprises still remain cautious, under the circumstances in which domestic demand will likely shrink due to a reduced population stemming from the further aging society with fewer children. Yet, as cash held by enterprises per se is abundant, investment in plants and equipment is predicted to increase, mainly in certain types of investment. Namely, 1) strategic investment in fields where rapid growth of some products and services is expected, 2) investment for maintenance and replacement, and 3) investment for rationalisation and saving.

Meanwhile, as Japanese enterprises maintain their cautious attitudes also to an increase in personnel expenses, labour's relative share in total value added has fallen to the lowest level since 1991. However, taking into account facts such as 1) a sense of labour shortages comes to be felt more and more strongly, and 2) corporate profits will likely continue to improve, the pace of rise in average wages is predicted to accelerate gradually.

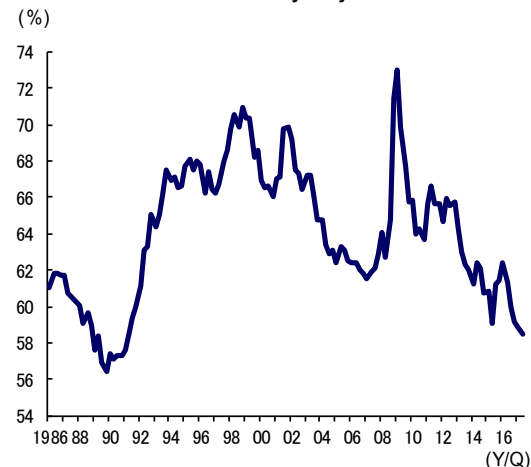
Figure 4-1 Ratio of Current Profits to Sales Planned by and Exchange Rate Assumed by Large Manufacturers



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

Note: Survey results in March, June, September, December, and subsequent estimates and actual results are shown in each fiscal year.

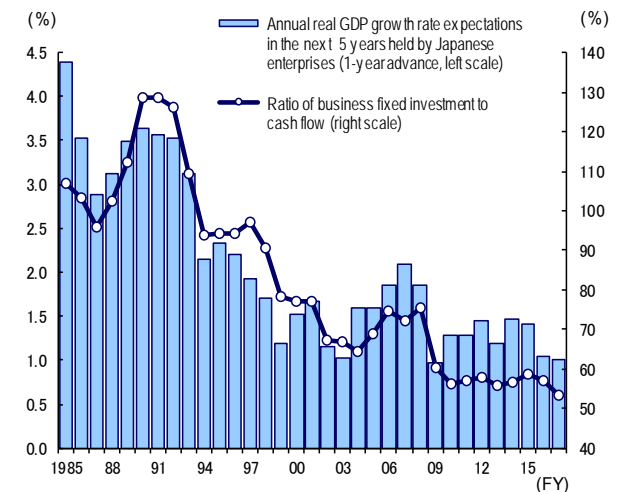
Figure 4-2 Labour's Relative Share in Total Value Added <seasonally adjusted>



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

Note: 1. All industries excluding financial institutions.
2. Labour's relative share = personnel expenses / total value added

Figure 4-3 Economic Growth Expectations and Ratio of Business Fixed Investment to Cash Flow



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

Monthly Report of Prospects for Japan's Economy December 2017
The Japan Research Institute, Limited

The pace of recovery in income is likely to continue to be slow

◆ Average wages have been slow to rise

Employment environments are on a mild improvement trend. In the current economic expanding phase since November 2012, the number of employed persons continues to increase, even in the situation where a population 15 years or over of age has been flat. It is particularly notable that the pace of increase this time has been at the fastest pace since the "bubble" boom period during 1986 - 91.

However, average wages have been slow to increase, even though the wages in industries where a shortage of workers has been especially serious such as transport and construction are on the rise. Analysed by size, first, it is mainly small enterprises that have raised wages. Yet, in this size of enterprises, the level of average wages has been relatively low. Second, in larger enterprises, the average rate of wage rises in negotiations this spring was almost the same as last year, with large enterprises being conscious of future uncertainties over, for example, overseas economies. In addition, bonuses this summer decreased year-on-year.

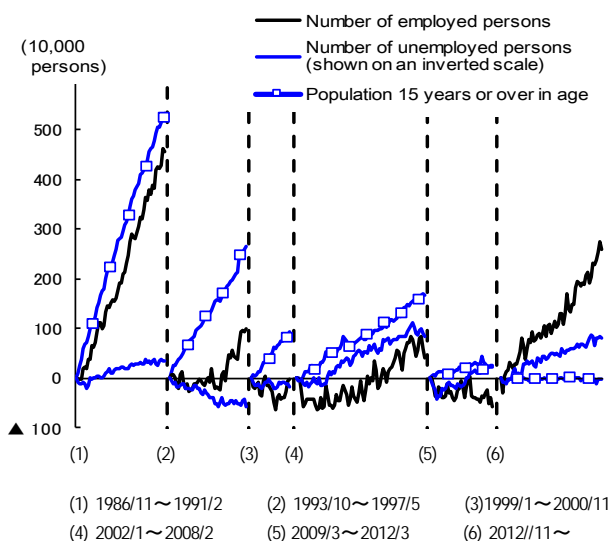
Analysed by industry, it is mainly industries with relatively lower wages that have seen a wage increase, such as 1) eating and drinking places, and accommodations, 2) health care and welfare, and 3) wholesale and retail trade. Actually, the pace of rise in average wages has slowed further after the start of FY2017.

◆ Slow pace of recovery in real income will likely continue

Looking ahead, the improvement in employment environments will likely continue, against the background of mild recovery in economic activity.

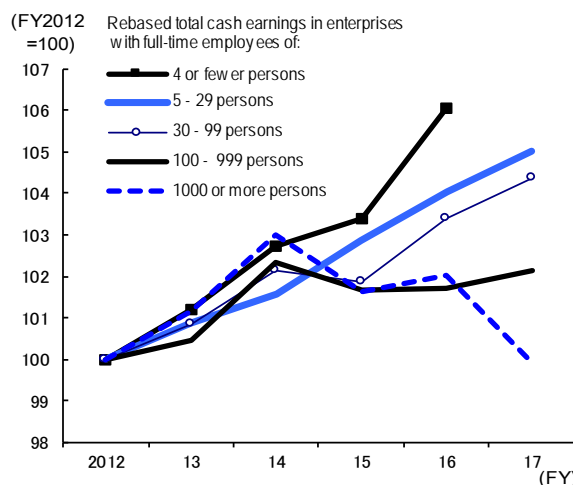
However, as for wage rises, it is predicted that the pace of rise in average wages will stay slow. Reflecting the fact that the wage increase rate in negotiations this spring stayed as low as last year, an improvement in regular-time pay this year will likely remain modest to the end of FY2017. In addition, the year-on-year change rate in consumer prices has turned positive, albeit slightly, due to energy price rises and the effect of the weaker yen. Unfavourably, this will likely add downward pressure on the real purchasing power of households.

Figure 5-1 Employment-related Indicators by Economic Expanding Phase in the Past and Present



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

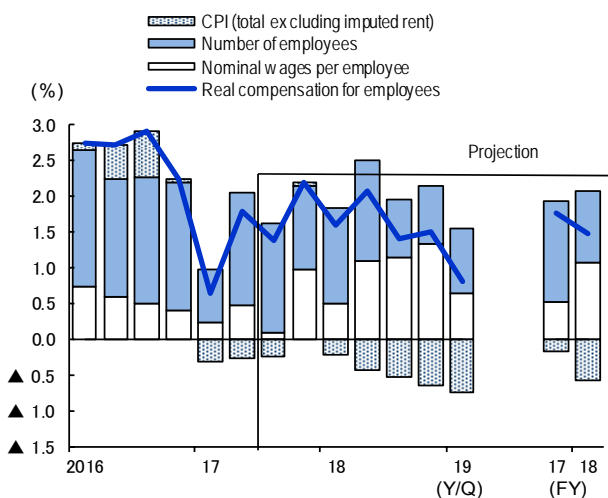
Figure 5-2 Total Cash Earnings in Full-Time Workers by Size of Enterprises <rebased>



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

Note: The figures in FY2017 are estimates which are calculated based on the year-on-year change in April-August 2017.

Figure 5-3 Contributions to the Year-on-Year Change Rate in Real Compensation for Employees



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

Monthly Report of Prospects for Japan's Economy December 2017
The Japan Research Institute, Limited

Private consumption expenditure is likely to recover mildly

◆ Private consumption expenditure is on a mild recovery trend

Viewed by item, a reactionary fall in expenditure on durable goods has come to an end and demand for buying new ones has started to materialise. This reactionary fall had been originally caused by promoting measures for consumption after 2009, and a last minute surge before the rise in the consumption tax in 2014.

With respect to automobile sales, the problem of improper pre-shipment inspections, which was revealed in October, could have become a weighing factor. Yet, it is likely that the fall in sales due to the problem will be temporary. As for expenditure on services, a recovery has been seen, for example, in eating out.

These trends of recovery reflect a continued improvement in employment and income environments and an advance in consumer sentiment. Firm stock prices have also contributed to supporting the recovery in consumption as a whole.

◆ Slow pace of recovery in private consumption will likely continue

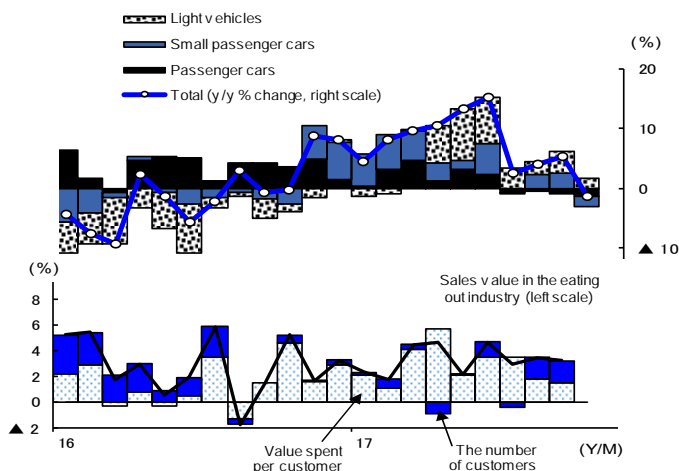
Looking ahead, the continued improvement in employment environments will likely go on bolstering the recovery in private consumption expenditure. However, the pace of the pickup in consumption is highly likely to remain slow, because both a slow

pace of wage rises and an increase in payments of social insurance premiums continue to weigh on disposable income.

Further, by age cohort, it is notable that the propensity to consume in the cohort less than the mid-30's has declined remarkably. The grounds for this are estimated to be that 1) no new attractive products or services have been produced which can boost the consumption of the younger generation powerfully, and 2) this cohort of consumers tends to be economical against the background of anxiety about their future. It is also added that 3) the ratio of households which bought a house has risen under continued low interest rate environments, and, as a result, the increased burden of mortgage (housing loan) repayments has come to have suppressed the total private consumption expenditure.

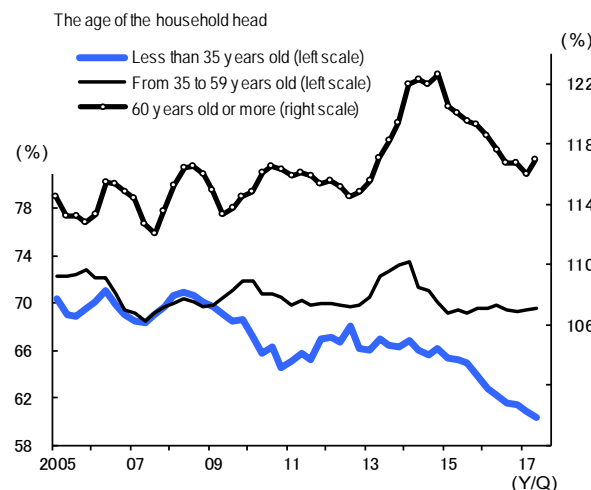
With respect to the cohort in which the head of household is 60 years old or more, taking into account the situation where the share of food and energy, the prices of which have risen, is relatively high in their total consumption, the real purchasing power in this cohort is likely to have been pushed down.

Figure 6-1 Number of Automobiles Sold and Sales Value in the Eating Out Industry <year-on-year % change>



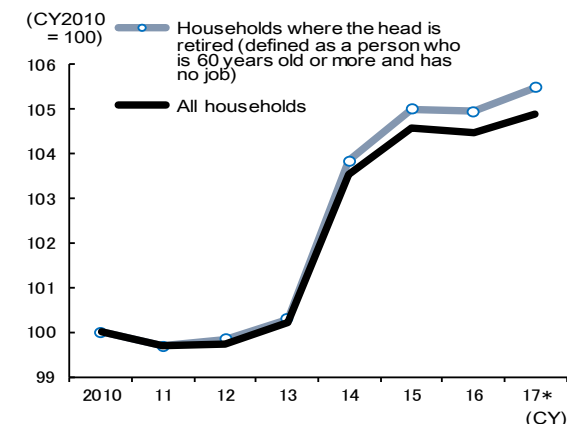
Source: The Japan Research Institute, Ltd. based on the data of Japan Automobile Dealers Association, Japan Light Vehicle and Motorcycle Association, Japan Food Service Association.

Figure 6-2 Average Propensity to Consume by the Age of the Household Head <4-quarter moving average>



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

Figure 6-3 Consumer Price Index for All Households and for Households where the Head is a Retired Person



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

Note: The figures in 2017 are for the average from January to September.

Monthly Report of Prospects for Japan's Economy December 2017
The Japan Research Institute, Limited

Topics : Building of houses for rent goes on overheating, especially in smaller ones

◆ Number of building of houses for rent with a small floor area has surged

The number of building of housing for rent has been at a high level of late. Especially, the ratio of houses for rent of which floor area is 30m² or less to the total has climbed from about 10 per cent in early 2014 to about 20 per cent in 2017. This trend has been seen visibly not only in metropolitan area such as Tokyo, Kansai area and Nagoya area, but also in local areas other than the above three largest city areas.

◆ The background behind the rapid rise in smaller houses for rent

The reason for the trend is the following. First, profitability of housing for rent for owners had improved through the middle of 2016, due to low interest rates and the fall in the prices of construction materials. Currently, profitability is back to the level in the middle of 2015. Second, the recent strengthening of inheritance taxation made the building of houses for rent more effective in tax saving.

Above all, "exceptions to tax rules applied to small residential land" have become an incentive for building housing for rent with a small floor area. This is because the

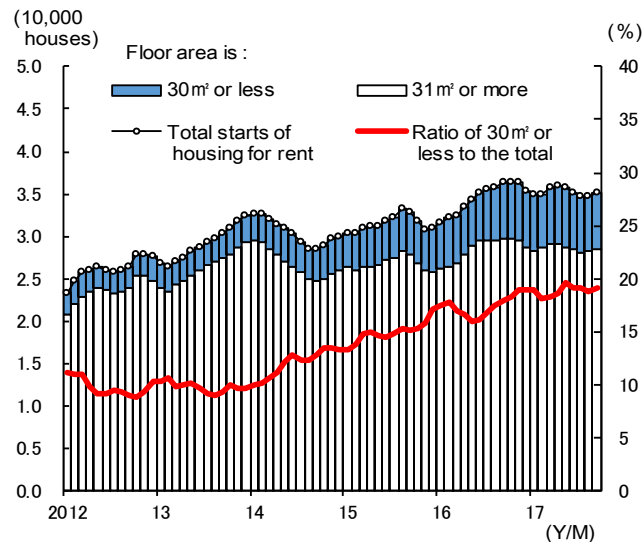
appraised value for inheritance taxation of small residential land to 200m² is reduced by 50 per cent, when the land was used for house for rent by the ancestor.

◆ Houses for rent with a small floor area have been recently oversupplied

Based on JRI estimates, potential demand for housing for rent with a small floor area is on a mild declining trend, albeit while moving up and down. The reason for this trend is that the number of young and single households, of which the ratio of residence in houses for rent with a small floor area is high, will likely decrease significantly, while demand for rebuilding will increase. Thus, it is highly likely that this type of houses have been oversupplied as seen below.

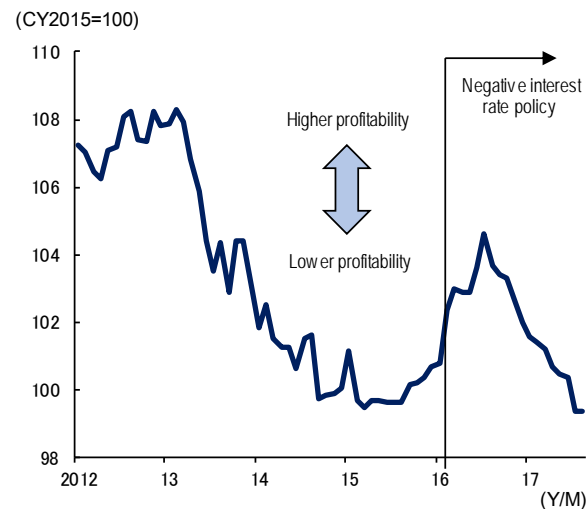
The actual number of starts of housing for rent with a small floor area is estimated to have been around 30,000 more than potential demand in 2016, and then 40,000 more as of September 2017. As a result, the rate of vacant rooms in this type of houses has rocketed from 15 per cent in early 2016 to 19 per cent in late 2017.

Figure 7-1 Starts of Housing for Rent by Size of Floor Area
<seasonally adjusted, 3-month moving averages>



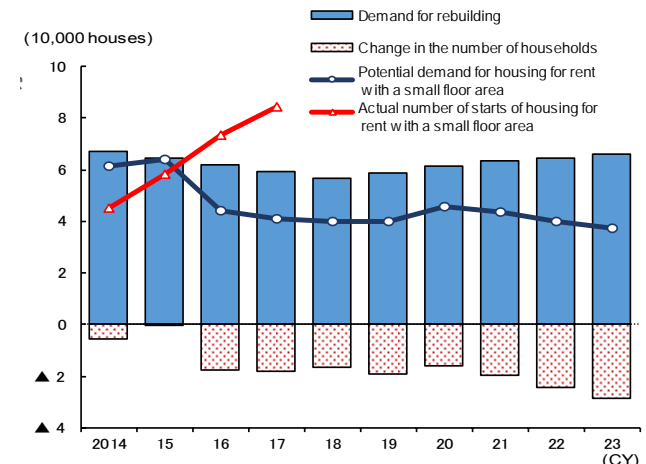
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Land, Infrastructure and Transport.

Figure 7-2 Profitability Index of Housing for Rent with a Small Floor Area



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

Figure 7-3 Potential Demand and Actual Results for Housing for Rent with a Small Floor Area



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications, National Institute of Population and Social Security Research (IPSS).

Note: The figure of housing starts in 2017 is an estimate.

Monthly Report of Prospects for Japan's Economy December 2017
The Japan Research Institute, Limited

Prospects for Japan's economy - Projected real GDP change; 1.5% in FY2017 and 1.2% in FY2018

◆ Japan's economic activity will likely continue its recovery trend, against the background of firm demand at home and abroad

(1) Japan's real GDP in the July-September period this year grew by 1.4 per cent on an annualised quarter-on-quarter change basis (national accounts, the first preliminary estimates), a positive figure for 7 quarters in a row.

Viewed by demand item, overseas demand defined as real net exports contributed considerably to the total growth, against the background of the picking up of exports. On the other hand, domestic demand resulted in negative contribution. Private consumption expenditure declined for the first time in 7 quarters, although the decline assumed an aspect of a reactionary fall from the high rate of growth in the previous quarter. Meanwhile, business fixed investment continued its positive growth.

Taking all into consideration, there is no alteration in the JRI view that Japan's economic activity continues to be on a mild recovery trend.

(2) Looking ahead, a decline on an annualised quarter-on-quarter change basis in public demand (public investment in the main) will weigh down the total real GDP growth rate, as the boosting effect of the economic measures fades out.

However, domestic private demand is predicted to remain firm. For example, business fixed investment will likely continue its positive quarterly growth, against the background of 1) buoyant domestic construction investment in nonmanufacturing driven by redevelopment projects in metropolitan areas as well as necessary accommodations for the rising number of foreign tourists to Japan, and 2) an increase in investment for R&D, chiefly in manufacturing.

As for overseas demand, it is projected that Japan's exports will continue their rising trend, partly reflecting an improvement in sentiment worldwide towards business fixed investment.

Judging from these elements, it is highly unlikely that the recovery trend in Japan's economic activity will falter. All in all, it is projected that real GDP in FY2017 will grow by 1.5 per cent, a relatively firm figure.

(3) With respect to economic activity in FY2018, it is predicted that exports will be supported by a firm pace of overseas economic growth, mainly led by US and Chinese economies. At the same time, domestic demand will likely continue to be firm against the background of 1) an increase in business fixed investment affected positively by buoyant corporate profits, 2) demand for construction related to the redevelopment in the metropolitan areas and the 2020 Tokyo Olympic and Paralympic Games, and 3) continued improvement in employment and income environments owing to labour shortages.

As a result, the trend of recovery will be sustained and real GDP will likely grow at a pace slightly over Japan's potential output growth rate, which is currently estimated to be roughly in the range of 0.6 to 1.0 per cent. Namely, it is projected that real GDP in FY2018 will grow by 1.2 per cent.

◆ The year-on-year change rate in the core CPI will likely be on a gradual rising trend

(4) The core CPI, which excludes fresh food, has enlarged the extent of its year-on-year increase, albeit slightly, since having turned into positive territory in January. Although the price of durable goods and communication charges continues to fall, a rise in energy prices has pushed up the total rate of increase on a year earlier.

Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will stay at about 1 per cent, against the background such as an improvement in supply-demand conditions on an aggregate basis, albeit with the pace of rise in energy prices slowing down.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of November 15, 2017)

	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)		
	CY2017			10 ~ 12	CY2018				CY2019	FY2016	FY2017	FY2018
	1 ~ 3	4 ~ 6	7 ~ 9		1 ~ 3	4 ~ 6	7 ~ 9	10 ~ 12	1 ~ 3	(Actual)	(Projection)	(Projection)
	(Actual)	(Actual)	(Actual)		(Projection)	(Projection)	(Projection)	(Projection)	(Projection)			
Real G D P	1.0	2.6	1.4	0.8	0.9	1.1	1.3	1.3	1.4	1.3	1.5	1.2
Private Consumption Expenditure	1.4	2.8	▲ 1.8	0.7	1.0	1.0	0.9	0.9	1.1	0.7	0.9	0.8
Housing Investment	3.5	4.6	▲ 3.5	▲ 3.2	▲ 0.4	▲ 0.2	0.8	3.2	6.4	6.6	1.5	0.2
Business Fixed Investment	2.0	1.9	1.0	2.4	2.8	3.0	3.0	2.9	2.8	2.5	2.4	2.8
Private Inventories (percentage points contribution)	(▲ 0.6)	(0.0)	(1.0)	(0.3)	(▲ 0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.4)	(▲ 0.1)	(0.1)
Government Consumption Expenditure	▲ 0.1	2.4	▲ 0.5	1.0	0.8	0.7	0.7	0.7	0.7	0.4	0.7	0.7
Public Investment	0.5	25.3	▲ 9.7	▲ 6.2	▲ 2.2	▲ 1.8	1.6	1.2	▲ 1.2	▲ 3.2	1.5	▲ 1.6
Net Exports (percentage points contribution)	(0.5)	(▲ 1.0)	(2.0)	(0.1)	(0.0)	(0.1)	(0.1)	(0.1)	(0.1)	(0.8)	(0.5)	(0.2)
Exports of Goods and Services	8.0	▲ 0.8	6.0	3.0	2.4	2.6	2.9	3.0	3.0	3.2	4.9	3.0
Imports of Goods and Services	5.6	5.7	▲ 6.2	2.7	2.4	2.4	2.4	2.5	2.5	▲ 1.3	2.3	1.9
(Ref.) Domestic Private Demand (percentage points contribution)	(0.6)	(2.0)	(0.0)	(1.0)	(0.9)	(1.0)	(1.0)	(1.1)	(1.2)	(0.6)	(0.8)	(0.9)
(Ref.) Public Demand (percentage points contribution)	(0.0)	(1.6)	(▲ 0.6)	(▲ 0.1)	(0.1)	(0.1)	(0.2)	(0.2)	(0.1)	(▲ 0.1)	(0.2)	(0.1)

	(% changes from the same quarter of the previous year)									(% changes from the previous fiscal year)		
	1 ~ 3	4 ~ 6	7 ~ 9	10 ~ 12	1 ~ 3	4 ~ 6	7 ~ 9	10 ~ 12	1 ~ 3	FY2016	FY2017	FY2018
Nominal G D P	0.7	1.0	1.7	1.6	2.1	1.8	1.7	1.7	1.9	1.1	1.6	1.8
GDP deflator	▲ 0.8	▲ 0.4	0.1	0.1	0.7	0.6	0.6	0.6	0.6	▲ 0.2	0.1	0.6
Consumer Price Index (excluding fresh food)	0.2	0.4	0.6	0.8	0.7	0.8	0.9	0.8	0.7	▲ 0.2	0.7	0.8
Unemployment Rate (%)	2.9	2.9	2.8	2.8	2.7	2.7	2.7	2.6	2.6	3.0	2.8	2.7
Exchange Rates (JY/US\$)	114	111	111	113	113	114	114	115	115	108	112	115
Import Price of Crude Oil (US\$/barrel)	55	53	50	58	60	61	61	62	62	47	55	61

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.