

# Monthly Report of Prospects for Japan's Economy

## December 2018

Macro Economic Research Center  
Economics Department



The Japan Research Institute, Limited

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

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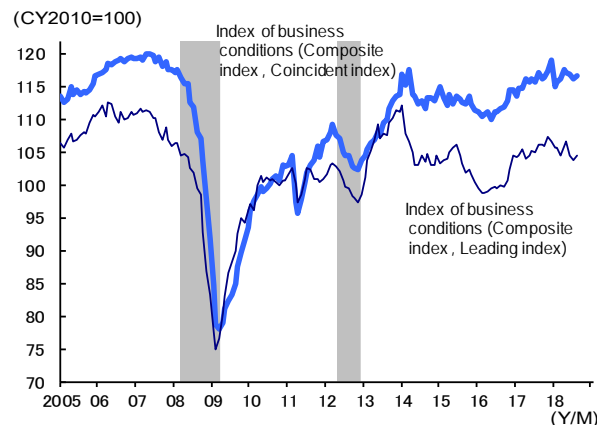
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# The General Situation of Japan's Economy – A Sense of Standstill Has Been Felt in the Recovery

**Figure 1-1 Economic Activity**

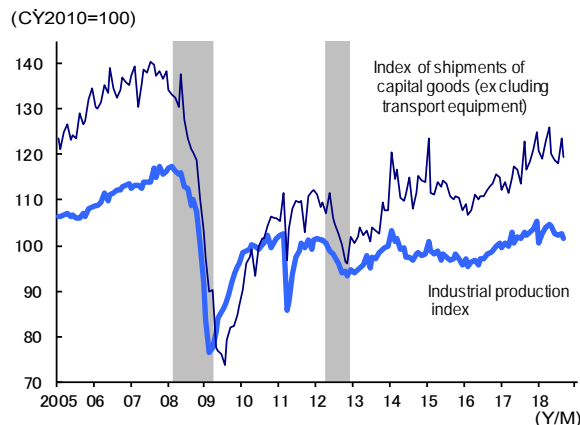
The CI coincident index rose for the first time in 4 months, reflecting an increase in shipments of durable consumer goods and investment goods.



Source: The Cabinet Office.

**Figure 1-2 The Corporate Sector**

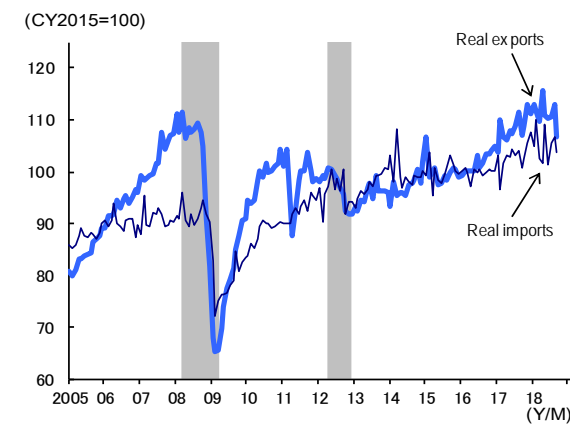
Industrial production decreased, partly affected by operational suspension in factories following natural disasters.



Source: The Ministry of Economy, Trade and Industry.

**Figure 1-3 Overseas Demand**

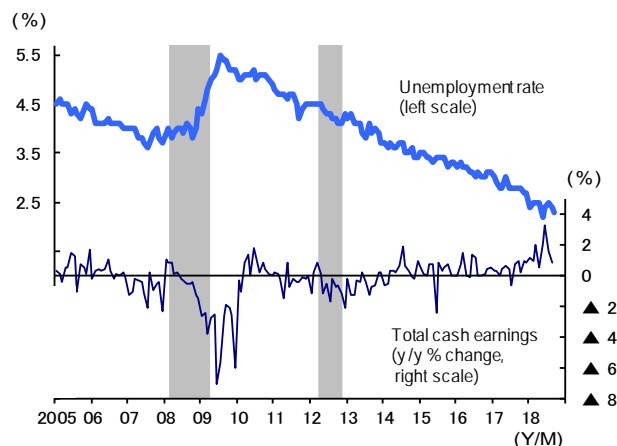
Real exports declined, affected by the temporary shutdown of the Kansai International Airport. Real imports, especially those of mineral fuels, decreased.



Source: The Bank of Japan.

**Figure 1-4 Employment and Income**

The unemployment rate was around the lowest level in 25 years. Nominal wages maintained the rising trend, albeit with some ups and downs.

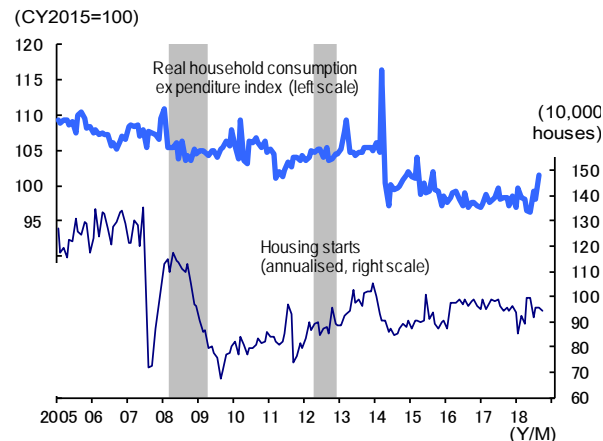


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

\* The shaded area indicates the recession phase.

**Figure 1-5 The Household Sector**

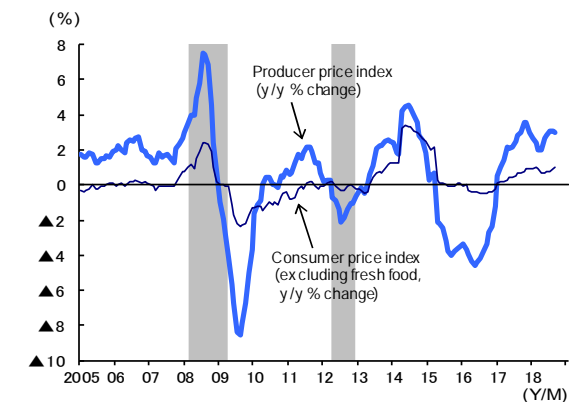
Real household consumption expenditure increased, led by the expenditure on automobiles. Housing starts for rental houses decreased.



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

**Figure 1-6 Prices**

The extent of year-on-year increases in producer prices was flat. Those in core consumer prices widened slightly, led by the rise in energy prices.



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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# The Economic Situation Is Currently Stalling Despite a Recovery Trend

## ◆ Industrial Production Continued to Weaken

The Industrial Production Index for September dropped 0.4 percent from the previous month in spite of the expectation of increased production. Production has been weakening due to the effect of a decline in exports of electronic parts as a result of the shutdown of the Kansai International Airport in September on top of the negative impact of operational suspension following the heavy rainfall in Western Japan in July. Nevertheless, production is estimated to pick up in the future on the back of recovery production and other measures, as industrial production is anticipated to increase 6.0 percent month over month in October (0.9 percent forecast by METI's flash estimates that reflect the correction of tendency errors in forecasts) and decrease 0.8 percent month over month in November.

## ◆ The Household Sector Remained at a Standstill

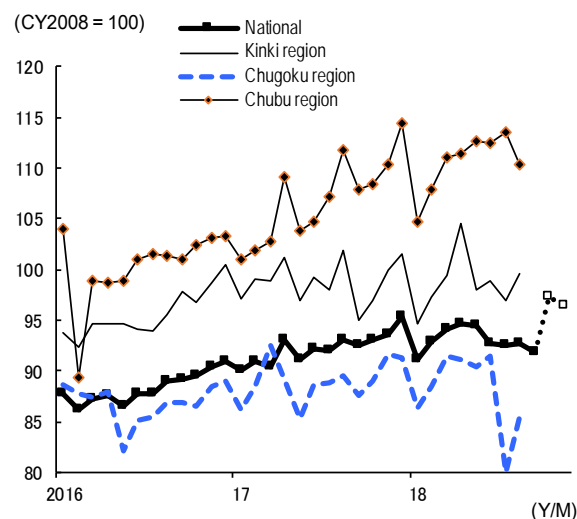
The Synthetic Consumption Index in August declined for the second consecutive

month. Negative contributing factors included temporary closure and shorter opening hours mainly among retail stores, as well as delays and cancellations of domestic travel due to the effects of natural disasters such as the heavy rainfall in Western Japan in July and typhoons in August.

## ◆ Economic Downturn Was Temporary

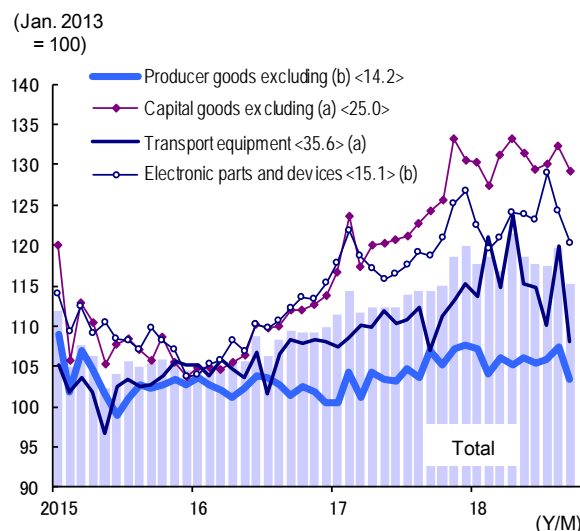
Notwithstanding the foregoing, it is judged that the economic recovery trend has continued on the back of solid corporate earnings and income conditions. Machinery orders, which are leading indicators of capital investment, remained brisk for general machinery and transportation machinery, and showed signs of a pick-up in the non-manufacturing industry. While the Economy Watchers Survey in September highlighted some concerns over the negative effects of natural disasters, the DIs for judging future economic conditions stood at 51.3, maintaining a level exceeding the 50-point mark that indicates a general trend of economic expansion.

Figure 2-1 Industrial Production by Region  
<seasonally adjusted>



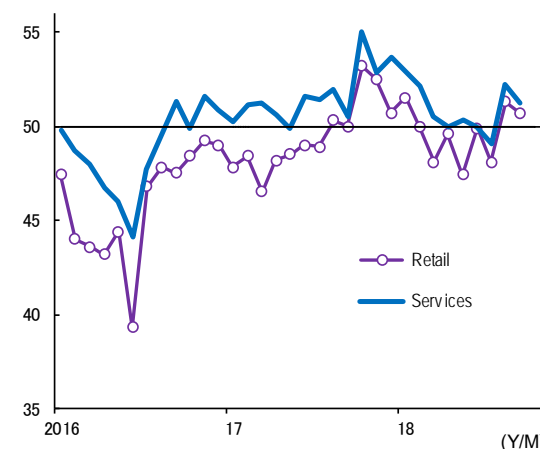
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.  
Note: The latest two figures in national total are based on the production forecast index.

Figure 2-2 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 FY2017.

Figure 2-3 DIs for Future Economic Conditions in Economy Watchers Survey  
<seasonally adjusted>



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

# Exports Will Likely Return to a Mild Rising Path

## ◆ Inbound Demand Has Weakened

Inbound demand has significantly dropped since July after the rising trend came to a halt. The number of overseas tourists visiting Japan has been decreasing by over 100,000 per month after peaking in June at 2.7 million due to the effects of heavy rainfall in Western Japan, typhoons and earthquakes.

However, the downturn caused by these natural disasters is expected to be temporary. The number of overseas tourists visiting Japan will likely pick up in the future amid continued expansion of income in Asian countries, development of an environment for receiving overseas tourists, and the waning effects of the disasters.

## ◆ Exports of Goods Will Likely Increase Moderately

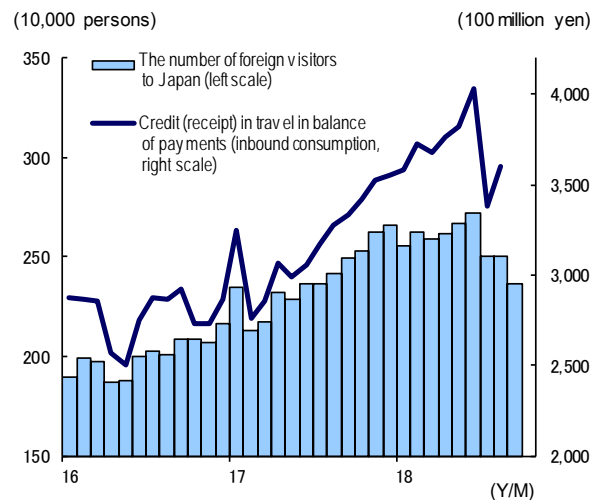
Japan's exports of goods have remained at a standstill since the beginning of the year. This reflected a slowdown in buoyant exports of electronic parts and devices to Asia as the demand for smartphones saw a temporary drop. Exports further decreased following the shutdown of the Kansai International Airport in September

despite arrangement of the Narita International Airport and Chubu International Airport as substitutes.

Nevertheless, it is judged that the current stagnation is a temporary slowdown in buoyant exports. In terms of outlook, exports, mainly of capital goods, will likely increase moderately. Exports of capital goods are expected to remain robust against the backdrop of the sophistication of production equipment and expansion in demand for infrastructure-related investment in emerging Asian countries, the main destination of the exports.

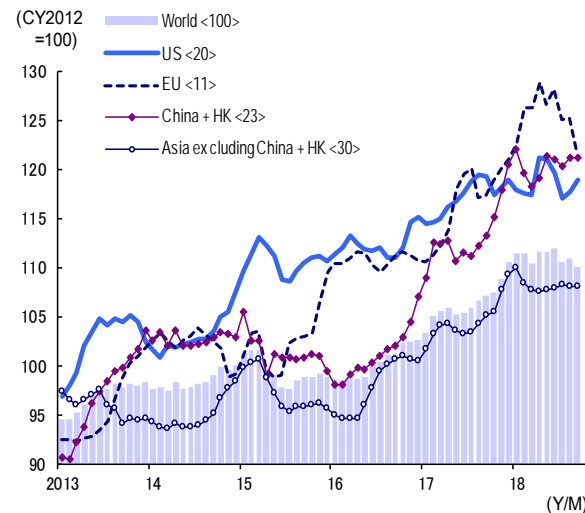
Meanwhile, trade friction with the United States will remain a risk. The hike in tariffs on automobiles has been put on hold for the time being due to the start of negotiations of the United States-Japan Trade Agreement on Goods (TAG). However, any hike in automobile-related tariffs by the U.S. administration will have a significant impact on Japan's exports.

Figure 3-1 Receipt in Travel in Balance of Payments <seasonally adjusted>



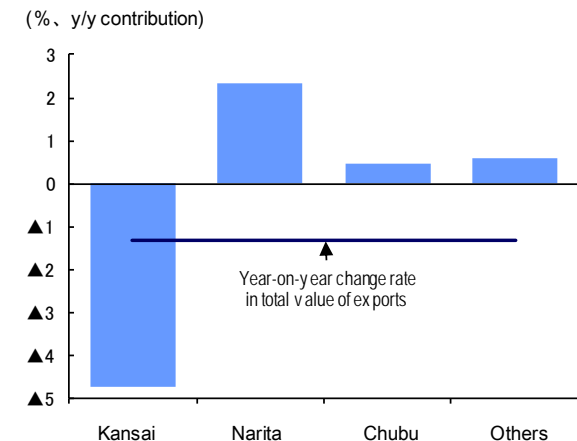
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, Japan National Tourism Organization (JNTO).

Figure 3-2 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: Figures in the angled brackets show the shares in total nominal exports in FY2017.

Figure 3-3 Contributions to Total Value of Exports by Location of Customs (September 2018)



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

# With Profits Continuing to Be Firm, Business Fixed Investment Is on a Rising Trend

## ◆ Corporate Profits Continue to Be Firm

Corporate earnings have remained strong. The ratio of current profits to sales for FY2018 was forecast to remain at a high level, although the ratio is anticipated to decrease from its highest on record, achieved in FY2017.

In addition to the rebound in consumer spending and capital investment, a rise in the sales prices of goods and services contributed to an increase in sales. While a rise in personnel expenses against the backdrop of a worsening labor shortage has continued to exert downward pressure on corporate earnings, labor's share has remained at a lower level as the growth in sales more than offset the negative effects.

Looking at the future outlook, corporate earnings will continue to follow a mild recovery path. As a result of reinforcement of the financial position through a reduction of variable expenses among others, the break-even point ratio in sales value has significantly decreased, thus realizing a structure where an increase in

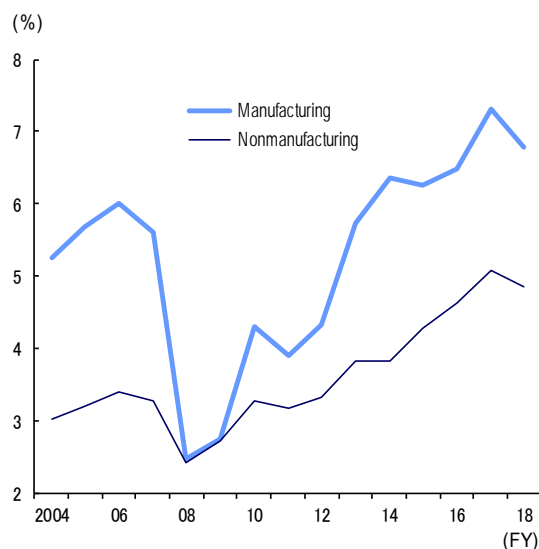
sales can directly lead to the expansion of bottom line profits.

## ◆ Business Fixed Investment Is on a Moderate Rising Trend

Reflecting abundant cash flow, capital investment has remained on an upward trend mainly in the fields of rationalization and labor saving against the backdrop of labor shortages. Furthermore, an expansion in forward-looking investment is expected in the future including commercialization of achievements of past research and development efforts.

However, since it is hard to estimate Japan's future growth outlook due to its declining population, and uncertainties surrounding the export environment have been increasing, reflecting intensification of trade friction between the United States and China, the momentum of capital investment will likely remain moderate compared with improvements in corporate earnings.

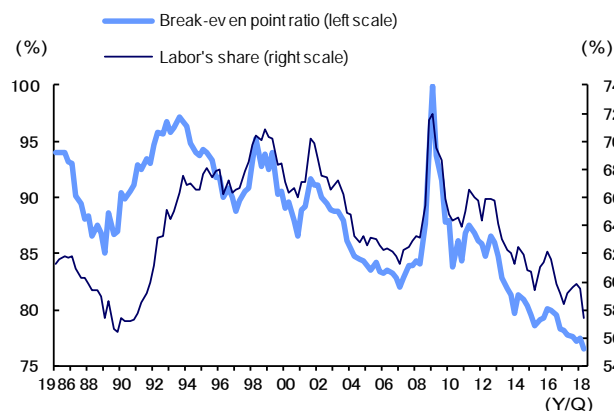
Figure 4-1 Ratio of Current Profits to Sales Based on BoJ's Tankan Survey <all sizes of industries>



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

Note: The figures for FY2018 are forecasts as of September.

Figure 4-2 Labor's Share and Break-even Point Ratio in Sales Value



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

Note: The break-even point ratio =  

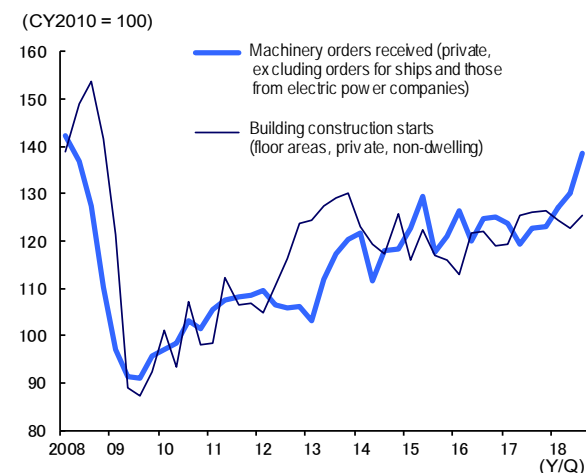
$$\text{break-even point ratio} = \frac{\text{break-even point sales value}}{\text{sales value}}$$

$$\text{Break-even point sales value} = \frac{\text{fixed costs}}{1 - (\text{variable costs} / \text{sales value})}$$

$$\text{Fixed costs} = \text{personnel expenses} + \text{depreciation expenses} + \text{interest payment}$$

$$\text{Variable costs} = \text{cost of goods sold} + \text{selling and administration expenses} - \text{personnel expenses} - \text{depreciation expenses}$$

Figure 4-3 Leading Indicators for Business Fixed Investment <seasonally adjusted>



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

Note: The latest figure in machinery orders is for July-August 2018.

# Income Is Likely to Recover Steadily

## ◆ Employment and Income Conditions Continue to Improve

The employment situation continued to improve. Since 2015, an increasing trend of hiring workers as regular employees has taken root, and job quality has significantly improved. At the same time, the number of non-regular employees substantially jumped since the beginning of this year. This reflected the advancement of a shift from non-workforce to part-time workers mainly among women as a result of the development of daycare facilities and the progress of work-style reform.

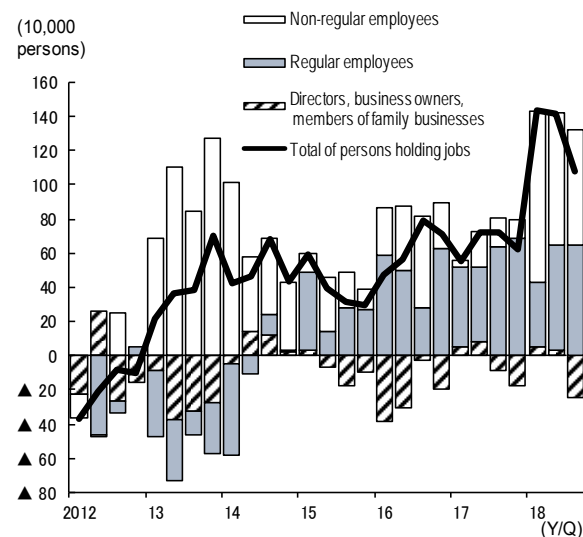
The pace of nominal wage growth also accelerated slightly due to the tightening of labor demand and supply conditions among other factors. Scheduled salaries for full-time workers have been rapidly increasing even after eliminating the effects of sample switchover. This year's summer bonuses also increased from those of previous years in a broad range of industries.

## ◆ Real Income Is Likely to Increase Firmly

As for the future outlook, as companies increasingly suffer from labor shortages across all industries, which have reached their severest point since the bubble economy, labor demand and supply conditions are likely to remain tight. As a result, both the employment situation and nominal wages are expected to continue to improve.

Real compensation for employees during the July-September period is anticipated to grow by around the 2 to 3 percent range on a year-on-year basis due to a rise in nominal wages, despite downward pressure from a hike in crude oil and vegetable prices. While this increasing trend will likely slow down due to a rise in prices after 2019, growth of around 1.5 percent is expected to be maintained.

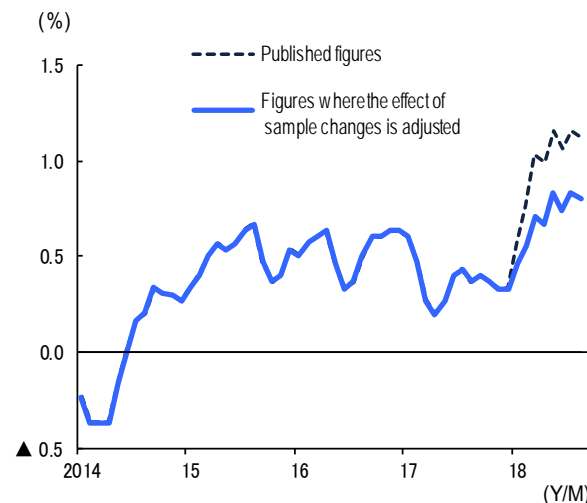
Figure 5-1 Number of Persons Holding Jobs  
<difference from a year earlier>



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

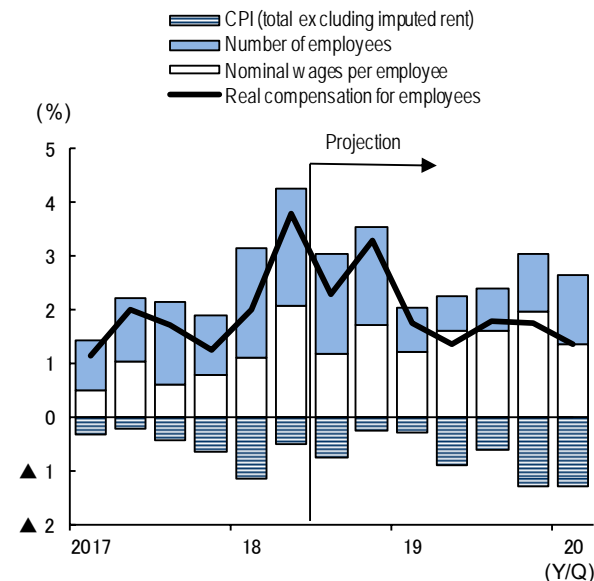
Note: Regular employees are persons employed for an indefinite period.

Figure 5-2 Scheduled Salaries for 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.

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



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

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# Stalling Private Consumption Expenditures Will Likely Pick up

## ◆ Private Consumption Remained at a Standstill

Consumer spending has been at a standstill. Household consumption was pushed down in September as consumers refrained from going out due to typhoons and earthquakes and the prices of crude oil and vegetables surged. Automobile sales in September declined on a year-on-year basis despite the effects of launching of new models of light vehicles. Consumer sentiment deteriorated in the Hokkaido and Kinki regions in particular.

On the contrary, the recovery of consumption continued in the service industry on the back of brisk employment and income conditions. Sales increased for food services as a result of a rise in sales per customer, reflecting price hikes and the promotion of seasonable menus. Looking at the consumption of durable goods, sales of automobiles significantly rebounded in October.

As for the future outlook, while private consumption will likely fluctuate due to weather-related factors and other reasons, consumer spending is expected to return to a moderate recovery path as employment and income conditions continue to

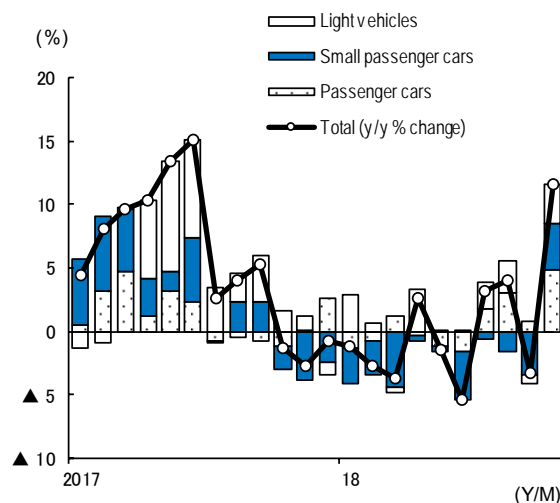
improve.

## ◆ Housing Investment Will Likely Remain Weak

The number of housing starts is forecast to remain weak. New construction for rental housing in particular will continue to decline on a year-on-year basis against the backdrop of subleasing contract issues and concerns over excessive supply as vacancy rates remain high. At the same time, the number of new construction projects for subdivision housing will likely decrease since the acquisition of land mainly in metropolitan areas is expected to remain difficult.

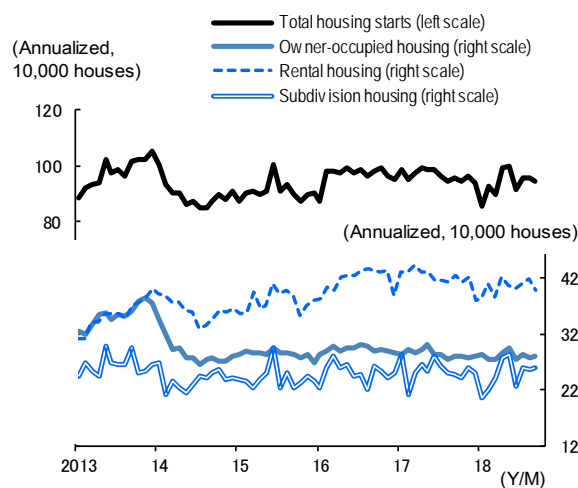
At the same time, investment in owner-occupied housing is expected to pick up on the back of the rush in demand anticipated prior to the rise in the consumption tax scheduled for October 2019, in addition to the improvement in the employment and income environment. In fact, the Index of Housing Business Sentiment for Custom-built Detached Houses for the 2018 July-September period showed signs of moderate recovery.

Figure 6-1 Number of Automobiles Sold  
<year-on-year % change>



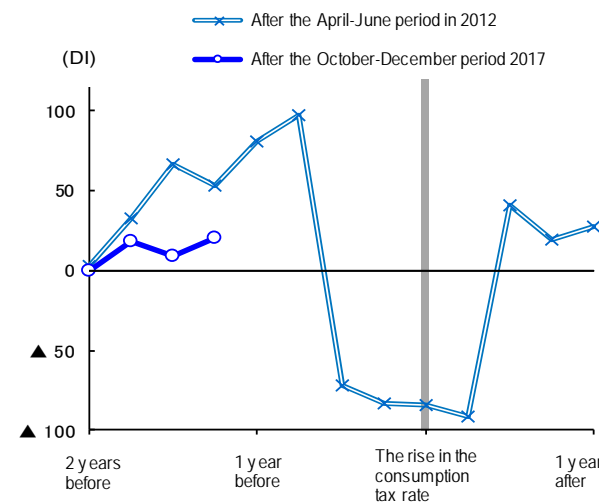
Source: The Japan Research Institute, Ltd. based on the data of Japan Automobile Dealers Association, Japan Light Vehicle and Motorcycle Association.

Figure 6-2 Housing Starts by Type  
<seasonally adjusted>



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

Figure 6-3 Index of Housing Business Sentiment for Custom-built Detached Houses



Source: The Japan Research Institute, Ltd. based on data of Japan Federation of Housing Organization.

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# Topics: Japan's Labor Supply Has the Potential for Further Expansion

## ◆ We Are Approaching the Upper Limit of Labor Supply

Amid a decline in the unemployment rate since the launch of Abenomics, the number of workers has been increasing by 500,000 per year. If the current pace of decline in the unemployment rate continues, in a few years it will reach the historic low recorded during the bubble economy period. In other words, we are steadily approaching the upper limit of labor supply.

## ◆ Japan's Untapped Workforce Has the Potential for Utilization

Notwithstanding the foregoing, Japan's untapped workforce of approximately 5 million workers has the potential to be utilized.

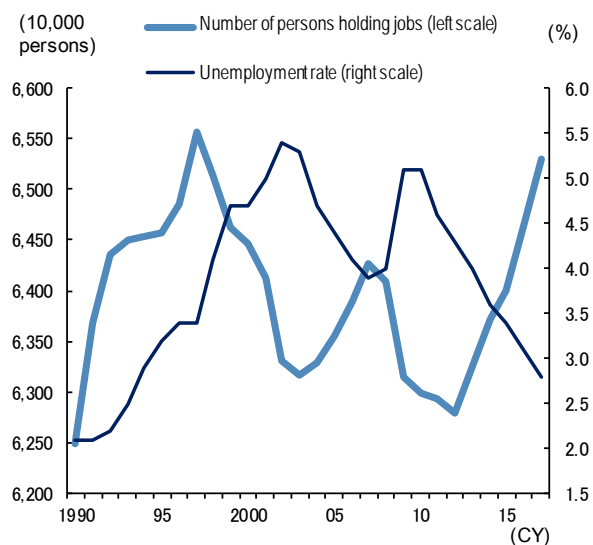
The first potential labor resource is the elderly aged 65 years and above. The number of elderly workers has increased by approximately 2 million during the past five years on the back of a rise in labor demand among other factors. At the same time, there were roughly 2 million elderly who wished to be employed but were not able to find a job in 2017. Reasons for this include the fact that there are mismatches in labor conditions between elderly jobseekers and companies in terms of age,

working hours and skills.

The second labor resource is the female workforce. The employment rate of female workers has been moderately increasing, and the issue of labor force participation rate, or the so-called M-shaped curve, has nearly been eliminated. Having said that, the number of women who were willing to work but could not practically do so due to restrictions on their time required for child rearing was approximately 3 million in 2017. In addition, there were approximately 1.3 million women who worked shorter hours than they wished. Behind this problem is the fact that it is difficult for women to work full-time due to child rearing and nursing of the elderly.

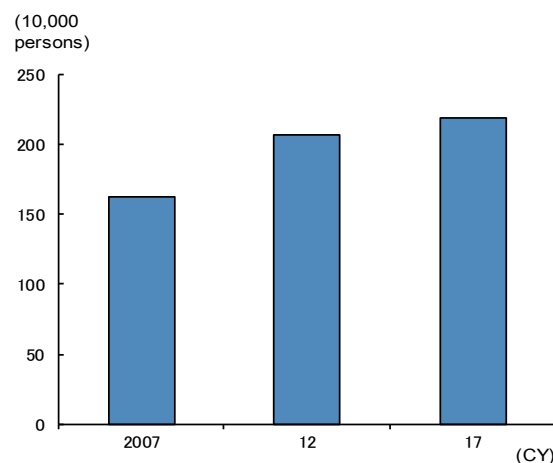
If we can utilize the aforementioned potent workforce, it will be possible for us to delay the labor supply from reaching its upper limit. For this purpose, it is indispensable to develop the environment to support both working and child rearing through the provision of versatile and flexible work style options by companies and the establishment of daycare facilities by the government.

Figure 7-1 Number of Persons Holding Jobs and Unemployment Rate



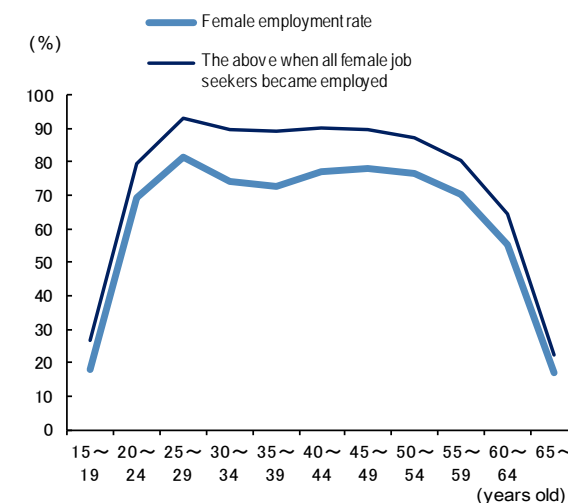
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

Figure 7-2 Number of the Elderly Aged 65 Years and Above Who Are Job Seekers



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

Figure 7-3 Female Employment Rate and Estimated Rate



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

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## Prospects for Japan's Economy - Projected Real GDP Change; 1.0% both in FY2018 and in FY2019

### ◆ Japan's Economic Activity Will Likely Turn to a Recovery Path, Driven by Firm Domestic Demand

(1) Japan's real GDP in the July-September period 2018 decreased by 1.2 percent on an annualized quarter-on-quarter change basis (national accounts, the first preliminary estimates), a negative figure for the first time in two quarters. The main reason for the downswing is the negative effects of natural disasters. Viewed by demand item, private consumption expenditure declined as consumers refrained from going out and consumer sentiment also deteriorated due to heavy rainfalls, typhoons and earthquakes. Exports, both those of goods and services, had a significant downswing, affected by operational suspension in factories, the shutdown of the Kansai International Airport, the fall in the number of overseas tourists visiting Japan, and so on.

(2) Looking ahead, it is predicted that the real GDP growth rate in the October-December quarter will turn positive to a relatively high figure as the effects of the natural disasters have run their course. Enterprises are arranging and carrying out their recovery production plans from the fall in production caused by the natural disasters. Also, the number of overseas tourists visiting Japan seems to be picking up gradually.

(3) Further, it is projected that economic activity in FY2019 will continue its recovery trend, driven by domestic demand. Viewed by demand item, business fixed investment will likely remain robust. It is true that uncertainties surrounding overseas economies such as intensification of trade friction between the United States and China and the slowdown in the Chinese economy are predicted to increase. However, the attitude of enterprises to capital investment will likely continue to be firm against the backdrop of corporate earnings at their high level, severe shortages of workers, superannuated plants and equipment, and so on. In addition, small and medium-sized enterprises will likely remain positive about capital investment.

(4) It is also predicted that private consumption expenditure will continue its moderate increasing trend, bolstered by good employment and income environments. Although a rise in the consumption tax rate is scheduled for October 2019, it is unlikely that private consumption expenditure will falter. This is because the extent of the rise in the consumption tax rate in 2019 will be less than that in April 2014, and the degree of burden of households is estimated to be small due to measures including the introduction of the reduced tax rate.

(5) As a result, real GDP will likely grow by around 1% both in FY2018 in FY2019, mainly led by domestic demand.

### ◆ The Year-on-year Change Rate in the Core CPI Will Likely Continue to Be around 1 Percent

(6) The pace of increase in the core CPI, which excludes fresh food, has accelerated slightly of late, mainly led by the rise in energy and food prices. Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will be around 1 percent. This is because, while the upward pressure will likely strengthen from the supply-demand perspective due to improvement in employment and income conditions, the pace of the rise in energy prices will likely gradually slow down.

Figure 9 Projections for GDP Growth and Main Indicators of Japan ( as of November 14, 2018 )

	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)			
	CY2018				CY2019				CY2020	FY2016	FY2017	FY2018	FY2019
	1 ~ 3	4 ~ 6	7 ~ 9	10 ~ 12	1 ~ 3	4 ~ 6	7 ~ 9	10 ~ 12	1 ~ 3	(Actual)	(Actual)	(Projection)	(Projection)
	(Actual)	(Actual)	(Actual)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Actual)	(Actual)	(Projection)	(Projection)
Real G D P	▲ 1.1	3.0	▲ 1.2	2.3	2.0	1.2	2.1	▲ 3.4	2.2	1.2	1.6	1.0	1.0
Private Consumption Expenditure	▲ 0.9	2.6	▲ 0.5	2.0	1.4	1.5	4.4	▲ 8.7	2.8	0.3	0.8	0.7	0.7
Housing Investment	▲ 8.0	▲ 7.5	2.6	3.0	6.7	0.0	▲ 1.5	▲ 7.0	▲ 3.9	6.2	▲ 0.3	▲ 4.3	0.3
Business Fixed Investment	3.0	13.0	▲ 0.9	3.5	2.8	2.6	2.6	2.4	2.4	1.2	3.1	4.8	2.5
Private Inventories (percentage points contribution)	(▲ 1.0)	( 0.2)	(▲ 0.3)	( 0.2)	(▲ 0.1)	(▲ 0.1)	(▲ 0.5)	( 0.3)	( 0.3)	(▲ 0.3)	( 0.1)	( 0.0)	(▲ 0.1)
Government Consumption Expenditure	0.1	0.8	0.7	1.0	1.0	0.6	0.6	0.6	0.6	0.5	0.7	0.6	0.7
Public Investment	▲ 1.9	▲ 1.3	▲ 7.5	0.5	6.9	1.3	▲ 2.7	▲ 1.5	0.3	0.9	1.5	▲ 2.4	0.5
Net Exports (percentage points contribution)	( 0.2)	(▲ 0.4)	(▲ 0.3)	( 0.2)	( 0.1)	(▲ 0.1)	(▲ 0.2)	( 1.1)	(▲ 0.1)	( 0.8)	( 0.4)	(▲ 0.0)	( 0.1)
Exports of Goods and Services	1.9	1.4	▲ 7.1	4.9	3.4	3.0	3.0	2.6	2.6	3.6	6.3	1.8	2.6
Imports of Goods and Services	0.6	4.2	▲ 5.6	3.7	2.6	3.7	4.3	▲ 3.4	3.0	▲ 0.8	4.1	2.0	2.1
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 1.2)	( 3.4)	(▲ 0.6)	( 2.0)	( 1.4)	( 1.2)	( 2.4)	(▲ 4.3)	( 2.1)	( 0.3)	( 1.0)	( 1.0)	( 0.7)
(Ref.) Public Demand (percentage points contribution)	(▲ 0.1)	( 0.1)	(▲ 0.2)	( 0.2)	( 0.5)	( 0.2)	(▲ 0.0)	( 0.0)	( 0.1)	( 0.1)	( 0.2)	(▲ 0.0)	( 0.2)

	(% 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	FY2019
Nominal G D P	1.5	1.4	0.0	0.2	1.9	1.6	2.6	1.9	1.6	1.0	1.7	0.9	1.9
GDP deflator	0.5	▲ 0.0	▲ 0.3	▲ 0.5	0.3	0.5	0.7	1.5	1.1	▲ 0.2	0.1	▲ 0.1	0.9
Consumer Price Index (excluding fresh food)	0.8	0.8	0.9	1.1	1.1	1.1	1.0	2.0	1.9	▲ 0.2	0.7	1.0	1.5
(excluding fresh food, consumption tax)	0.8	0.8	0.9	1.1	1.1	1.1	1.0	1.0	0.9	▲ 0.2	0.7	1.0	1.0
Unemployment Rate (%)	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.3	2.3	3.0	2.7	2.4	2.4
Exchange Rates (¥/US\$)	108	109	111	113	114	113	111	110	109	108	111	112	111
Import Price of Crude Oil (US\$/barrel)	67	71	76	80	74	73	73	73	73	47	57	75	73

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.