

Monthly Report of Prospects for Japan's Economy

June 2021

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

This report is the revised English version of the May 2021 issue of the original Japanese version.

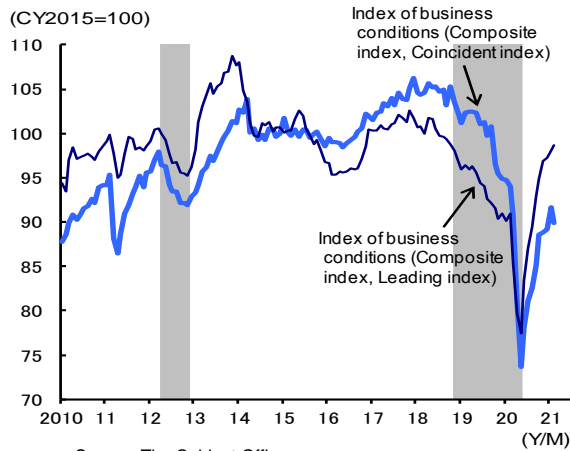
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The General Situation – Economic Recovery Has Come to a Halt

Figure 1-1 Economic Activity

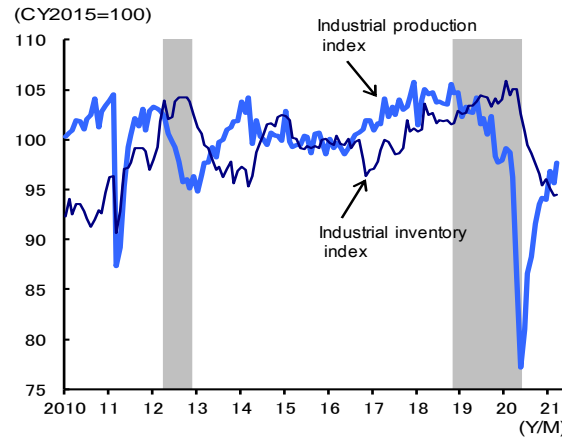
While the CI leading index continued to rise, the CI coincident index leveled off.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

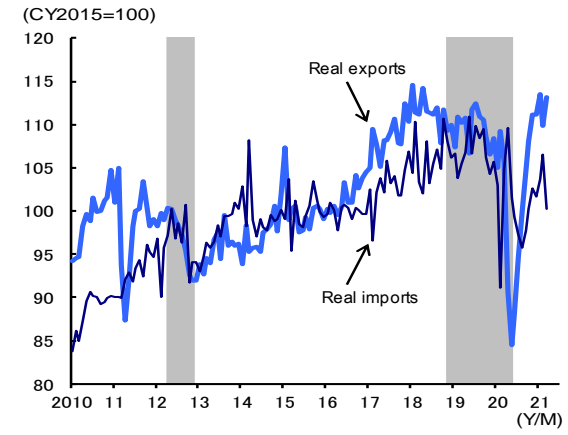
Industrial production has been increasing in a wide range of industries, albeit with fluctuations.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

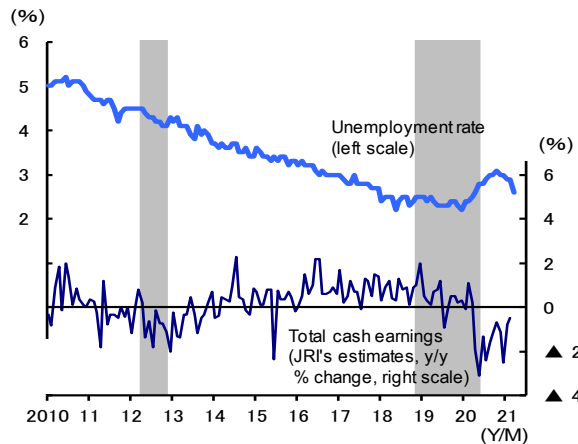
Exports are on a rising trend, mainly in Asia. Imports decreased temporarily in reaction to the rapid recovery.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate remained between the high twos and the roughly three percent level. Nominal wages declined, mainly for special salaries (bonuses).

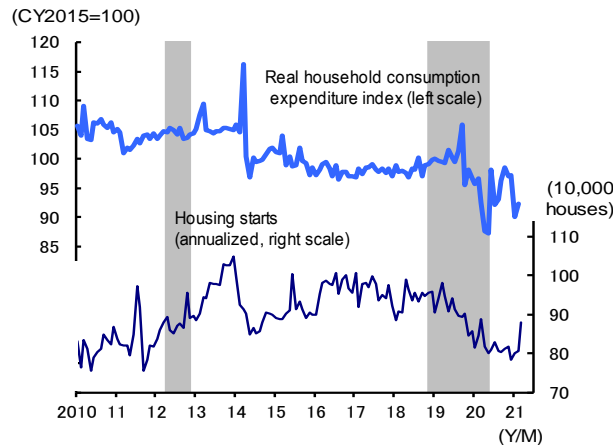


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

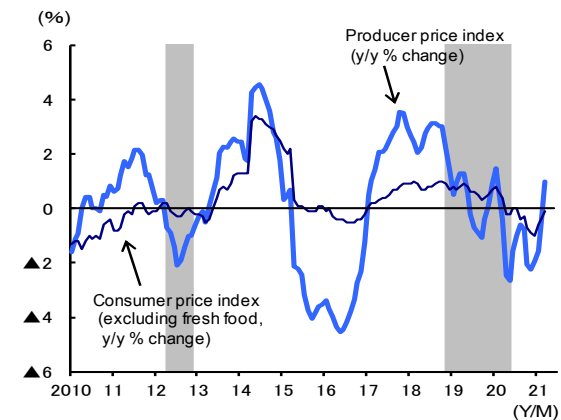
Real consumption saw some ups and downs due to the effect of COVID-19. Housing starts remained at the low level of 800,000 units.



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

Figure 1-6 Prices

Producer prices increased due to a rise in crude oil prices. The decline in consumer prices diminished.



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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Exports and Production Remained Firm, While Personal Consumption Saw Some Ups and Downs

◆ Exports and Production Are on a Rising Trend

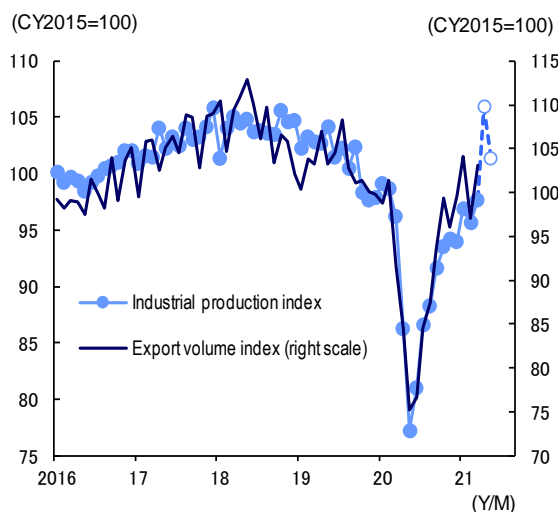
Exports remained on a recovery path, if seasonal fluctuations due to the Chinese New Year are ironed out. Export volume in March 2021 increased by 6.2% from the previous month, up for the first time in two months. By region, exports to China and other Asian countries led the overall increase.

Production activities in the manufacturing industry have generally continued to recover on the back of increased exports. Looking at future production plans, while the production of transportation machinery is set to drop by 10% or more due to a shortage of parts caused by a fire at a semiconductor plant and so on, production of electronic parts and manufacturing machinery is expected to increase, reflecting brisk external demand. As a result, it is forecast that production activity from a macroeconomic perspective will continue to expand.

◆ Resurgence of COVID-19 Weighs on Consumption

Meanwhile, personal consumption has seen some ups and downs. Japan's Real Consumption Activity Index (travel balance adjusted) for February 2021 rose 1.3% from the previous month, up for the first time in two months, as the second state of emergency declaration had been lifted in some regions. After the state of emergency declaration was lifted nationwide in March, consumption activities seemed to have picked up further. However, the number of new COVID-19 cases increased again from the beginning of April, and tougher measures to control the spread of COVID-19 (so called "Manbo") were applied to some regions while a third state of emergency declaration was issued targeting Tokyo, Osaka, Kyoto and Hyogo prefectures. This resulted in the deterioration of consumption once again. The Consumer Confidence Index in April 2021 fell 1.4 points from the previous month, down for the first time in three months.

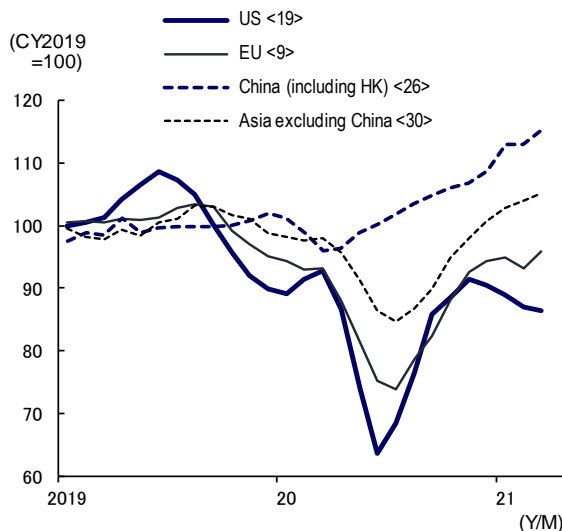
Figure 2-1 Industrial Production and Export Volume <seasonally adjusted>



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

Note: The latest two figures in the industrial production index are forecasts based on the production forecast index.

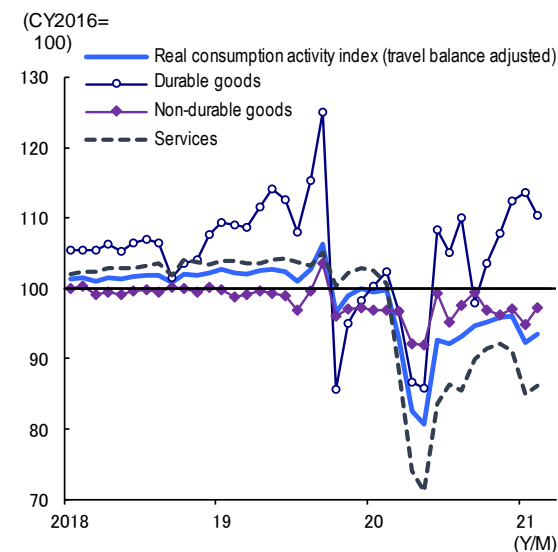
Figure 2-2 Real Exports by Destination <seasonally adjusted>



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

Note: 1. 3-month moving averages.
2. Figures in the angled brackets show the shares in total nominal exports in CY2020.

Figure 2-3 Real Consumption Activity Index <seasonally adjusted>



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

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Exports of Goods Remained on a Recovery Trend

◆ Exports Were Led by Electronic Parts and Capital Goods

Goods exports remained on a rising trend on the whole. By item, while shipments of transportation machinery, mainly to Europe and the United States, were sluggish, those for electronic parts and devices remained firm as global demand for semiconductors picked up and shipments of capital goods increased, primarily to China.

Looking ahead, shipments of transportation machinery are expected to remain weak for the foreseeable future given the shortage in semiconductor supply for automotive production. Demand for electronic parts and devices as well as capital goods will likely drive exports on the whole against the backdrop of the expansion of telework, an increase in demand for 5G-related products, and growth in capital investment in line with the sophistication of industries in China. Looking at the Bank of Japan's March 2021 Tankan Survey, it is predicted that production machinery and

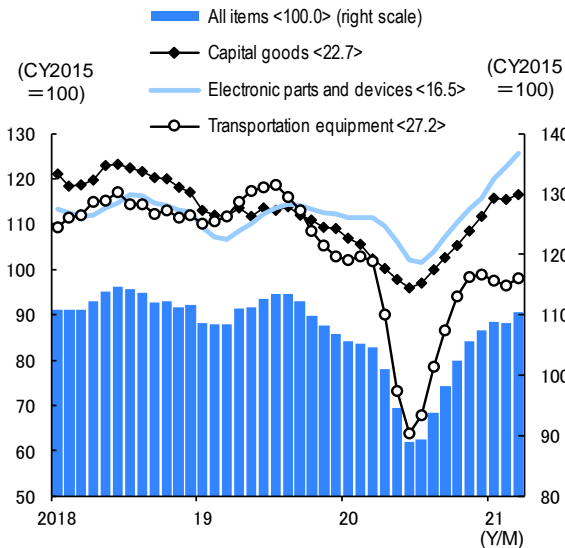
other processing industries will likely see a further improvement in supply and demand going forward for products overseas.

◆ Sluggish Demand Related to Inbound Tourism Will Likely Continue

Amid restrictions on overseas travel around the world, the number of tourists visiting Japan remained virtually nonexistent.

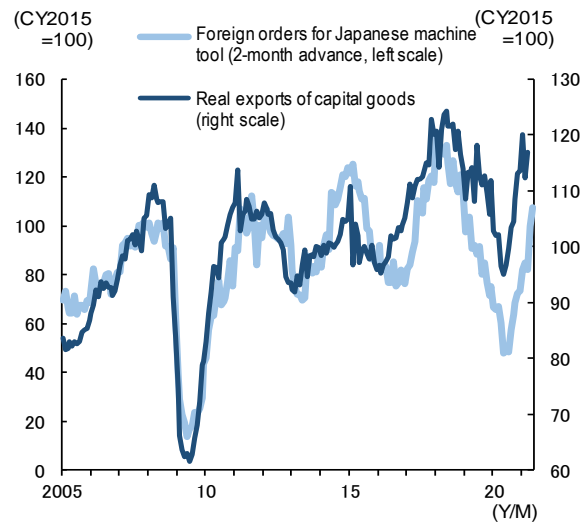
It is difficult for the Japanese government to ease entry restrictions for tourists until COVID-19 infections settle down both in Japan and overseas. Given this situation, recovery in demand related to inbound tourism cannot be expected for the foreseeable future. The International Civil Aviation Organization (ICAO) predicts that the number of passengers around the world at the end of 2021 will recover to around 50% of the level prior to the outbreak of COVID-19. However, in Japan, where the rollout of COVID-19 vaccines has been delayed, the recovery in the movement of people across national borders may be slower than in other developed countries.

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



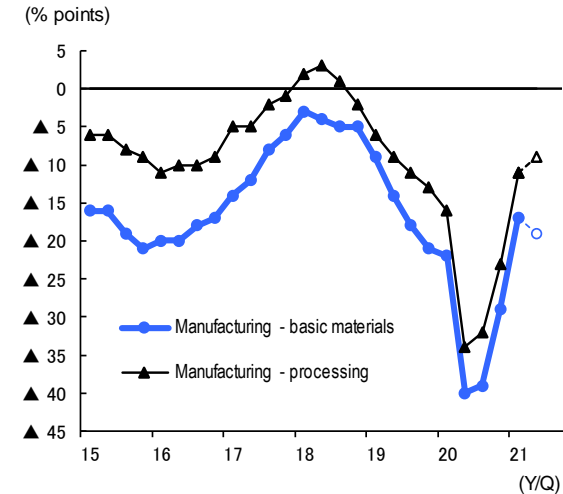
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: 1. 3-month moving averages.
2. Figures in the angled brackets show the shares in total nominal exports in CY2020.

Figure 3-2 Machine Tool Orders and Exports of Capital Goods
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of Japan Machine Tool Builders' Association, The Ministry of Finance.

Figure 3-3 DI for Overseas Supply and Demand Conditions for Products
<all sizes of enterprises>



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

Note: The latest figures are forecasts based on March 2021 Tankan Survey.

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Corporate Earnings Have Been Polarized, While Business Fixed Investment Is Expected to Rebound

◆ Corporate Earnings Have Become Polarized

In the October-December 2020 period, sales on an industry-wide basis increased 2.5% from the previous quarter and current profits increased 15.5% from the previous quarter, up for the second consecutive quarter. However, it appears that corporate earnings for the January-March 2021 period have become polarized. While the manufacturing sector seems to have posted increased sales and profits on the back of brisk goods exports, the personal services industry such as restaurants and bars recorded further losses due to the direct effects of the issuance of the second state of emergency declaration.

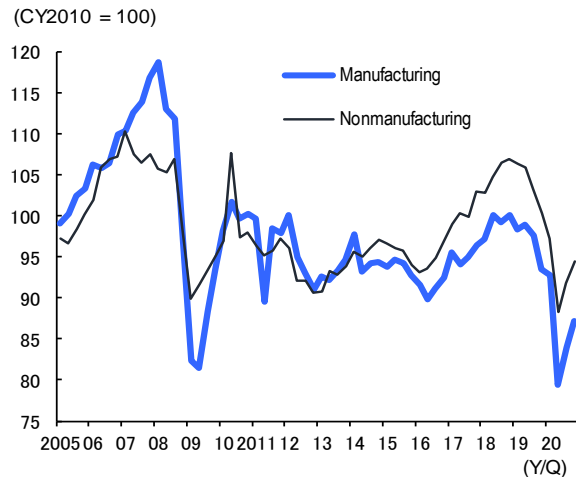
As for future prospects, the manufacturing sector is expected to see continued improvement in earnings on the back of an increase in exports, reflecting overseas economic recovery, while the non-manufacturing sector related to consumption will likely face extremely challenging earnings conditions as the number of new COVID-

19 cases remains high in Japan. Meanwhile, in the third state of emergency declaration issued in April, large-scale retail facilities as well as food services providers are included in the targets of operational restrictions. Therefore, the decline in earnings due to the impact of restrictions on activities will likely have ripple effects on some sections of the retail industry as well.

◆ Companies Have Resumed Capital Investment

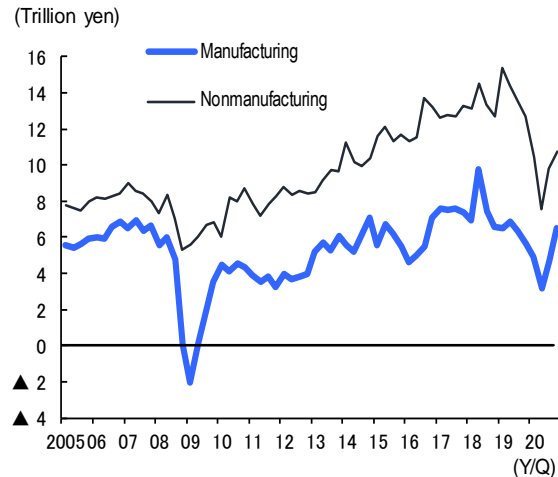
Capital expenditure for the October-December 2020 period decreased 1.4% on an industry-wide basis, down for the third consecutive quarter. Since the beginning of 2021, manufacturers, whose business performance has been showing a prominent recovery, have begun to resume postponed investment activities. Capital expenditure plans (large enterprises, industry-wide basis) for fiscal 2021 are 3.0% higher than those of the previous year, which indicates that they are solid as initial plans. Given the above, business fixed investment is expected to pick up going forward.

Figure 4-1 Sales Value of Japanese Corporations by Type
<seasonally adjusted>



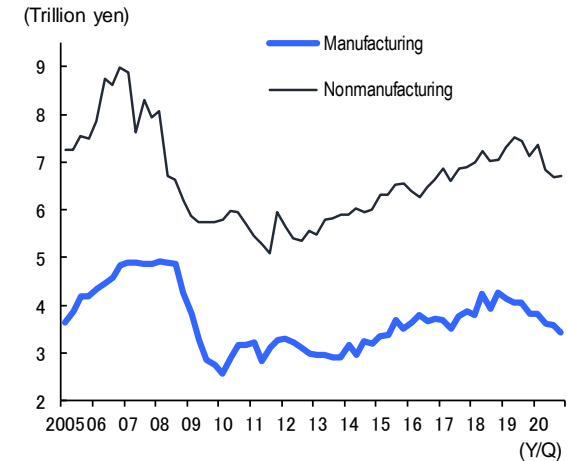
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 4-2 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 4-3 Business Fixed Investment of Japanese Corporations by Type
<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.

Recovery in Employment and Income Conditions Will Be Delayed Due to the Effects of Restrictions on Activities

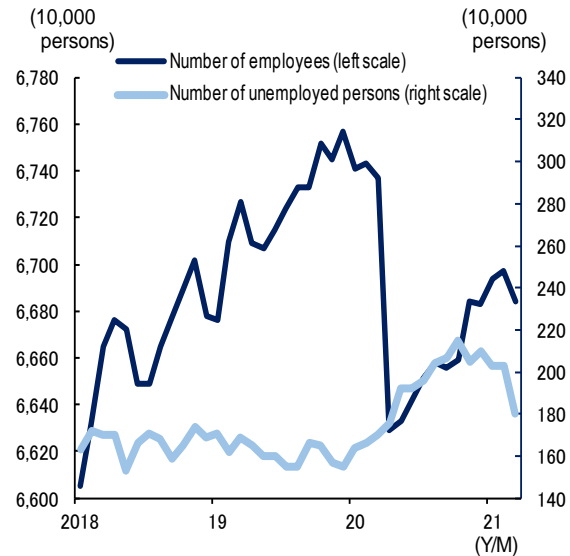
◆ Further Employment Adjustment Is Inevitable in the Food Services Industry

The number of unemployed persons in March 2021 decreased by 230,000 from the previous month, while the number of workers also saw a decline of 130,000 month-over-month. A rapid increase in the number of unemployed persons has been avoided—partly because many companies are maintaining employment in view of worsening labor shortages over the medium to long term—thanks to the use of employment adjustment subsidies, for which the relaxation in payment requirements has been extended. However, the creation of new employment opportunities is limited. With tougher measures to control the spread of COVID-19 (so-called “Manbo”) and the third state of emergency declaration issued since the beginning of April, pressure for employment adjustment in the food services industry and so on is expected to rise again in the future.

◆ Total Cash Earnings Saw a Decline

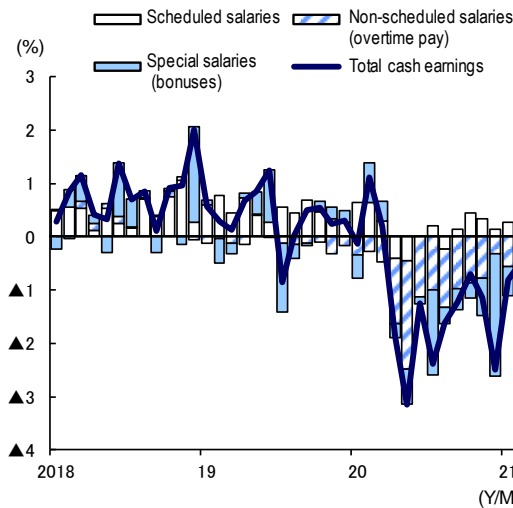
COVID-19 has also had ripple effects on wages. Total cash earnings (on the basis of common business establishments) in February 2021 plunged 0.5% year-on-year, recording a year-on-year decline for the eleventh consecutive month. Regarding future prospects, while non-scheduled salaries (overtime pay) will likely return to positive territory upon the recovery of economic activity, there will be strong downward pressure on scheduled salaries against the background of the perception of a bloated workforce, which will remain at a high level, among other factors. As a result, the wage increase rate for this year’s spring labor offensive seems to have fallen below 2% for the first time since 2013. In addition, some major companies have failed to fully reflect the worsening of their business performance due to the COVID-19 pandemic in their bonuses for the previous fiscal year, and it is inevitable that their special salaries will decline further. Therefore, it is difficult to expect that overall wages will improve in earnest.

Figure 5-1 Number of Employees and Number of Unemployed Persons



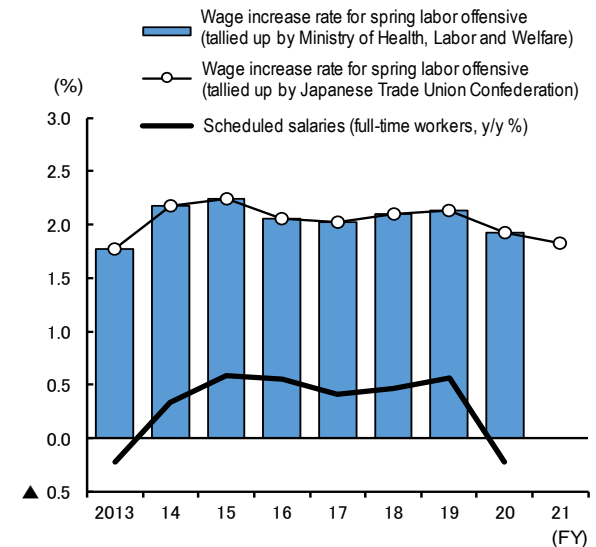
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Contributions to Change Rate of Nominal Wages <year-on-year % change>



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

Figure 5-3 Wage Increase Rate for Spring Labor Offensive



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

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Private Consumption Will Likely Remain Sluggish for a Long Period of Time

◆ Consumption Saw Some Ups and Downs Due to Restrictions on Activities

Based on credit card settlements in March 2021, consumption was down 6.8% compared to the same month in 2018, at which time there was no impact from the consumption tax hike. The decline diminished from the previous month (down 9.0% compared to the same month in 2018). There were signs of recovery in consumption as the second state of emergency declaration was gradually lifted.

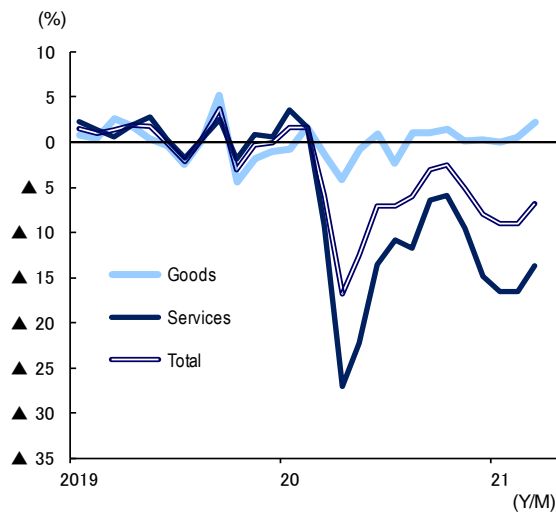
Despite the foregoing, the decline in consumption seems to have increased again since the beginning of April. As a fourth wave of COVID-19 infections hit Japan, the government announced tougher measures to control the spread of COVID-19 (so called “Manbo”) and the third state of emergency declaration, which resulted in a decline in the number of people visiting retail and entertainment venues once again. Although the target areas of the latest state of emergency declaration are smaller compared to those of the previous state of emergency declaration (January-March

2021), it required not only restaurants and bars to shorten their hours of operation but also large-scale retail facilities to suspend business or shorten their hours of operation. As a result, there will likely be a certain level of negative impact on goods consumption.

◆ Recovery in Personal Consumption Will Not Become Clear Until This Autumn

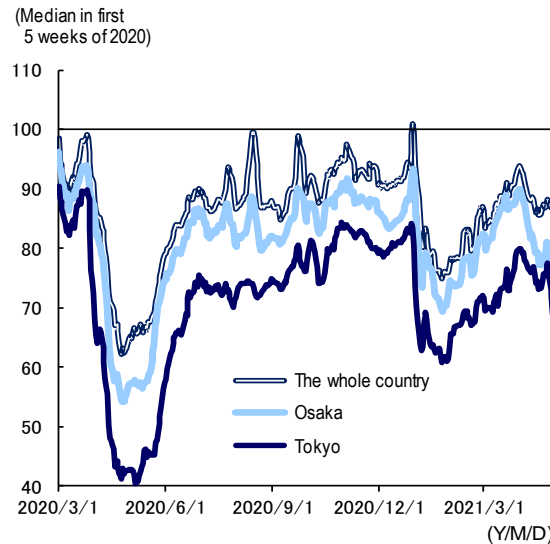
As for future prospects, even if the latest state of emergency declaration is lifted, restrictions on activities will likely be imposed again due to the resurgence of infections in the future until the rollout of COVID-19 vaccines progresses to a certain extent. Given the delay in recovery of employment and income conditions, private spending is expected to see some ups and downs. It is predicted that the recovery in personal consumption will not become clear until this autumn and thereafter, when COVID-19 vaccines become widely available among the elderly and other groups.

Figure 6-1 Consumption Based on Credit Card Settlements <compared to the same month in 2018>



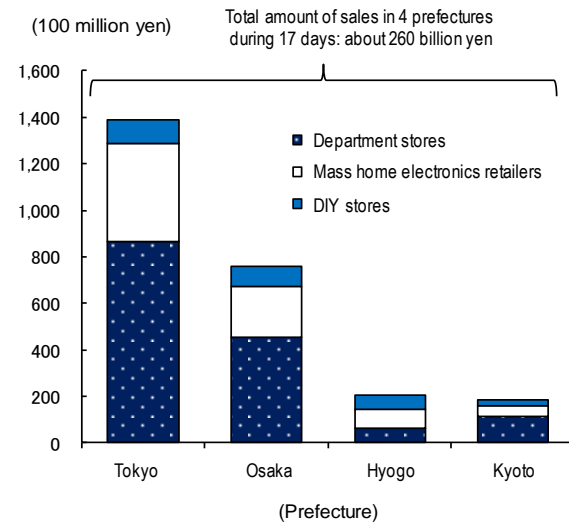
Source: The Japan Research Institute, Ltd. based on data of JCB Consumption NOW.

Figure 6-2 Number of People Who Visited Retail and Entertainment Facilities



Source: The Japan Research Institute, Ltd. based on data of Google "Covid-19 community mobility report."
Note: 7-day moving averages.

Figure 6-3 Sales in Large Retail Facilities during 17 Days



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

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Topic: Private Spending Has Become Polarized Between Budget-Oriented Consumers and Those Seeking Luxury Goods

◆ There Has Been a Shift Toward Consumption of Luxury Goods

In the wake of the COVID-19 pandemic, there has been a shift toward the consumption of luxury goods, as evidenced by brisk sales of imported luxury cars and high-end home appliances while consumers refrain from service consumption such as travel and leisure. On the other hand, some have pointed out that consumers are becoming more budget-minded due to the worsening employment and income situation.

According to the Family Income and Expenditure Survey, the ratio of items that shifted toward “premiumization,” for which the unit purchase prices increased more than consumer prices, rose in 2020, indicating that the preference for luxury items surpassed that for budget items on average. It is estimated that the shift toward higher-end products boosted personal consumption by 0.3% in 2020.

◆ There Has Been Some Variance by Product Category and Household Type

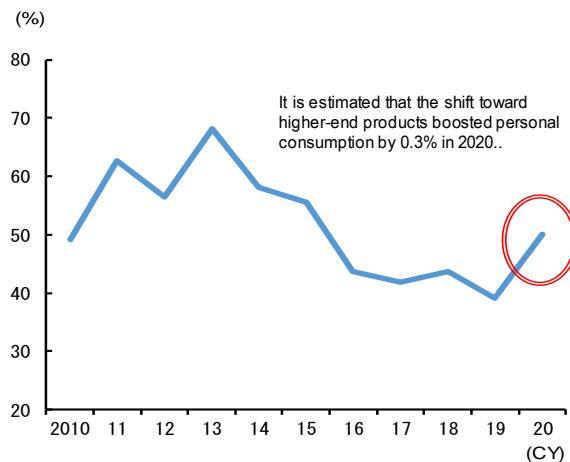
By product category, the shift to higher-quality products has been remarkable for

items such as home appliances and bedding, reflecting strong stay-at-home demand. In the area of food products, a shift to higher-quality products has mainly been witnessed for seasonings and ham. On the other hand, the tendency to save money has been prominent in clothing. In this sector, in addition to a sharp decline in consumption volume, a shift to lower-priced products also placed significant downward pressure on consumption.

There has also been great variance by household type. Non-working households, of which the majority is comprised of pensioners, and high-income working households are shifting toward the consumption of luxury goods. In contrast, budget-orientation has been prominent among low-income earners, who have faced an extremely challenging income environment.

Due to the effects of the prolonged COVID-19 pandemic, consumption markets will likely continue to see a mix of winners and losers and the polarization of spending activities for a long period of time.

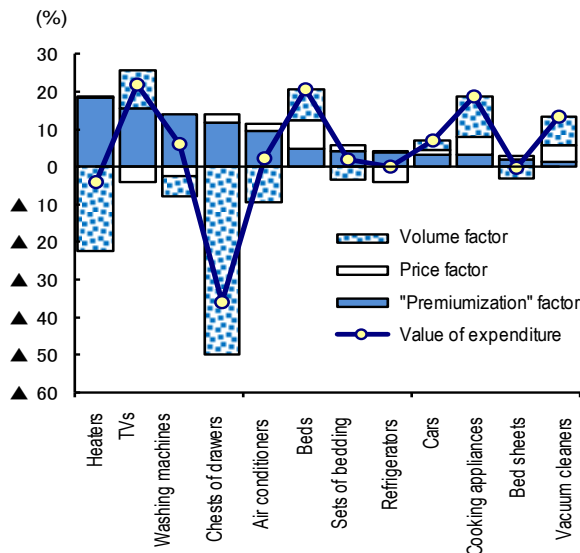
Figure 7-1 The Ratio of Items That Shifted toward “Premiumization”



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

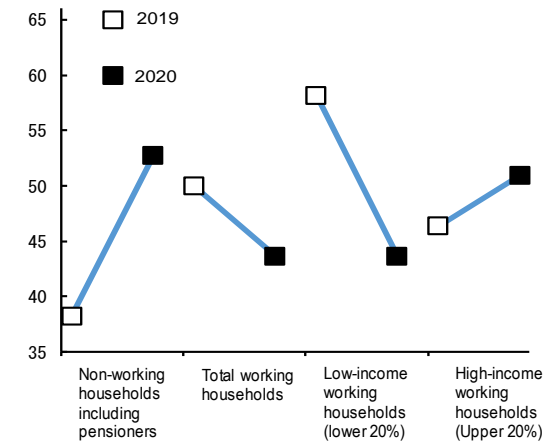
Note: The ratio of items that shifted toward “premiumization,” for which the unit purchase prices increased more than consumer prices.

Figure 7-2 Value of Expenditure by item <year-on-year % change, 2000>



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

Figure 7-3 The Ratio of Items That Shifted toward “Premiumization” by Household Type



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

Prospects for Japan's Economy - Projected Real GDP Change; 3.4% for FY2021 and 2.8% for FY2022

◆ Economic Recovery Will Not Likely Become Clear Until This Autumn

(1) Japan's real GDP for the January-March 2021 period was -5.1% on an annualized quarter-on-quarter change basis (down 1.3% from the preceding quarter), recording negative growth for the first time in three quarters. The economic decline was attributable mainly to the downturn in private consumption. The issuance of the second state of emergency declaration due to the resurgence of COVID-19 infections has resulted in a significant decline in service consumption.

(2) As for future prospects, while the issuance and extension of the third state of emergency declaration will likely weigh on economic recovery during the April-June 2021 period, negative growth is expected to be avoided since (i) exports and business fixed investment are likely to remain robust on the back of the recovery of overseas economies and (ii) companies and households are responding more flexibly to the state of emergency declaration. Given the weak resilience, however, it is forecast that the Japanese economy will not recover fully from the decline in the January-March 2021 period.

(3) Furthermore, Japan's economy is anticipated to see some ups and downs in the lead-up to summer. Since the rollout of the COVID-19 vaccines is taking time, it is inevitable that restrictions on economic activities will be imposed intermittently through the state of emergency declaration and tougher measures to control the spread of COVID-19 (so-called "Manbo") in order to prevent the spread of the virus even after the current state of emergency declaration is lifted. Therefore, it is predicted that consumption activities will continue to be affected by the COVID-19 situation and case numbers.

(4) On the other hand, economic recovery is expected to become clear after this autumn on the assumption that the rollout of COVID-19 vaccines will progress to a certain extent. Since elderly households, which are at higher risk of severe illness from COVID-19, are tending to be more cautious about spending activities, consumption activities are expected to pick up if COVID-19 vaccines become widely available among the elderly.

(5) As a result, Japan's growth rate for FY2021 is expected to be +3.4%, which is not sufficient to fully recover from the decline recorded in FY2020 (-4.6%). It is forecast that Japan's GDP will recover to the peak level prior to the outbreak of COVID-19 (July-September 2019 period) around the July-September 2022 period.

◆ Prices Have Been Declining

(6) In March 2021, core CPI declined 0.1% year-on-year, showing a smaller year-on-year decline compared with that in the previous month. This is attributable mainly to the fact the decline in energy prices diminished as a result of the recovery in crude oil prices.

As for the future outlook, while energy prices are expected to increase year-on-year, there will be strong downward pressure on prices from the viewpoint of supply and demand conditions and mobile charges are scheduled to be reduced. Consequently, core CPI will likely remain in negative territory for the time being.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of May 18, 2021)

	(seasonally adjusted, annualized % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2020		1~3	CY2021			CY2022				CY2023	FY2020	FY2021	FY2022
	7~9	10~12		4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)
	(Actual)	(Actual)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Actual)	(Projection)	(Projection)	
Real GDP	22.9	11.6	▲ 5.1	2.6	1.9	3.9	4.2	3.5	1.7	1.3	1.3	▲ 4.6	3.4	2.8
Private Consumption Expenditure	22.0	9.0	▲ 5.4	0.9	0.1	5.6	5.9	5.4	2.1	1.5	1.5	▲ 6.0	2.5	3.8
Housing Investment	▲ 21.0	0.3	4.5	3.9	▲ 2.0	▲ 0.4	3.5	3.1	1.9	0.2	0.0	▲ 7.1	0.2	1.6
Business Fixed Investment	▲ 8.1	18.3	▲ 5.5	6.9	4.4	4.4	3.1	2.8	2.8	2.5	2.2	▲ 6.9	3.9	3.0
Private Inventories (percentage points contribution)	(▲ 0.8)	(▲ 2.0)	(1.1)	(▲ 0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.2)	(▲ 0.1)	(0.0)
Government Consumption Expenditure	11.9	7.3	▲ 6.9	2.8	3.6	▲ 1.0	1.8	0.6	0.4	0.4	0.4	3.1	1.6	0.7
Public Investment	2.9	4.7	▲ 4.2	0.2	0.8	1.0	0.4	0.0	▲ 0.5	▲ 0.6	0.0	4.0	0.3	0.0
Net Exports (percentage points contribution)	(11.2)	(4.2)	(▲ 0.9)	(0.3)	(0.4)	(0.4)	(0.0)	(▲ 0.0)	(0.0)	(0.1)	(0.1)	(▲ 0.6)	(1.1)	(0.1)
Exports of Goods and Services	32.5	55.7	9.7	5.5	6.4	6.4	5.2	4.8	4.8	3.9	3.9	▲ 10.4	13.0	5.0
Imports of Goods and Services	▲ 29.0	20.7	16.8	3.6	4.1	4.4	5.2	5.2	4.8	3.7	3.7	▲ 6.8	5.7	4.7
(Ref.) Domestic Private Demand (percentage points contribution)	(7.8)	(5.3)	(▲ 2.6)	(1.6)	(0.7)	(3.7)	(3.8)	(3.4)	(1.6)	(1.2)	(1.2)	(▲ 4.9)	(1.8)	(2.6)
(Ref.) Public Demand (percentage points contribution)	(2.7)	(1.8)	(▲ 1.7)	(0.6)	(0.8)	(▲ 0.2)	(0.4)	(0.1)	(0.1)	(0.1)	(0.1)	(0.8)	(0.4)	(0.2)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)
Nominal GDP	▲ 4.5	▲ 0.8	▲ 2.1	6.6	1.7	0.3	3.3	3.9	3.8	2.8	2.1	▲ 4.0	2.9	3.1
GDP deflator	1.2	0.2	▲ 0.2	▲ 0.9	▲ 1.0	▲ 0.4	0.3	0.6	0.5	0.2	0.1	0.6	▲ 0.5	0.3
Consumer Price Index (excluding fresh food)	▲ 0.2	▲ 0.9	▲ 0.4	▲ 0.3	▲ 0.2	0.6	0.1	0.7	0.5	0.4	0.4	▲ 0.4	0.0	0.5
(excluding fresh food, consumption tax, education free of charge)	▲ 0.5	▲ 0.9	▲ 0.3	▲ 0.3	▲ 0.2	0.6	0.1	0.7	0.5	0.4	0.4	▲ 0.5	0.0	0.5
Unemployment Rate (%)	3.0	3.1	2.8	3.0	3.2	3.2	3.1	3.0	2.9	2.9	2.8	2.9	3.1	2.9
Exchange Rates (JY/US\$)	106	104	106	109	110	111	112	112	111	112	113	106	111	112
Import Price of Crude Oil (US\$/barrel)	41	44	55	67	68	66	64	64	67	64	63	43	66	65

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.