

Monthly Report of Prospects for Japan's Economy

August 2021

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

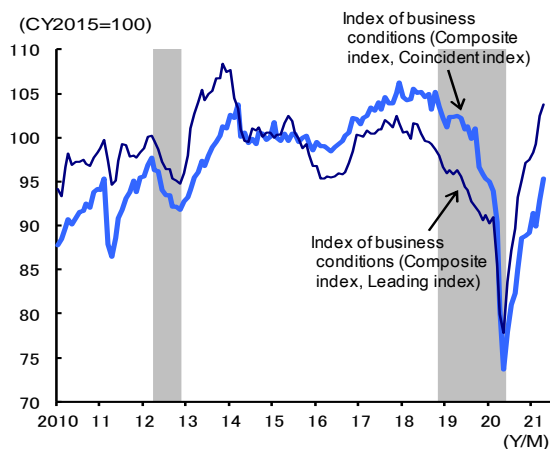
This report is the revised English version of the July 2021 issue of the original Japanese version.

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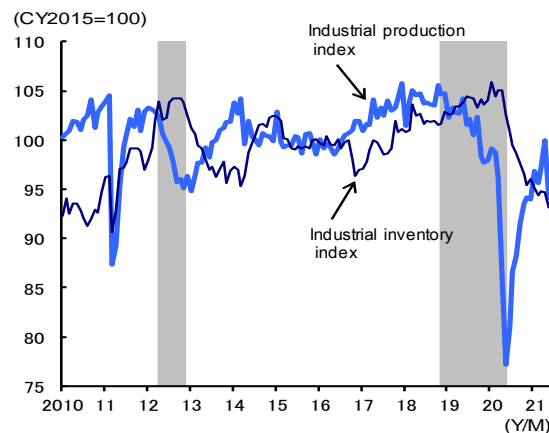
The General Situation – Economic Activity Picked up, While the Recovery Was Lackluster in Some Areas

Figure 1-1 Economic Activity
Both the CI leading index and the CI coincident index rose.



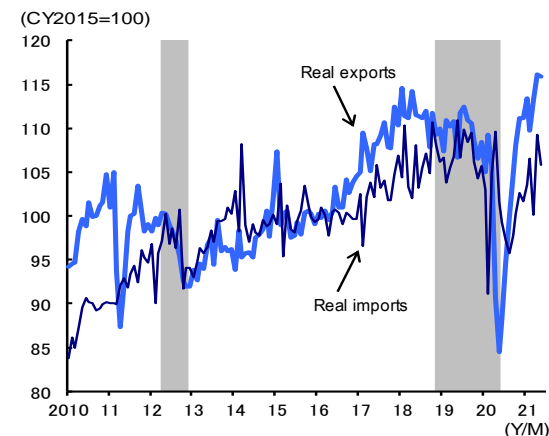
Source: The Cabinet Office.

Figure 1-2 The Corporate Sector
Industrial production temporarily declined due to the supply shortage of semiconductor-related automobile components.



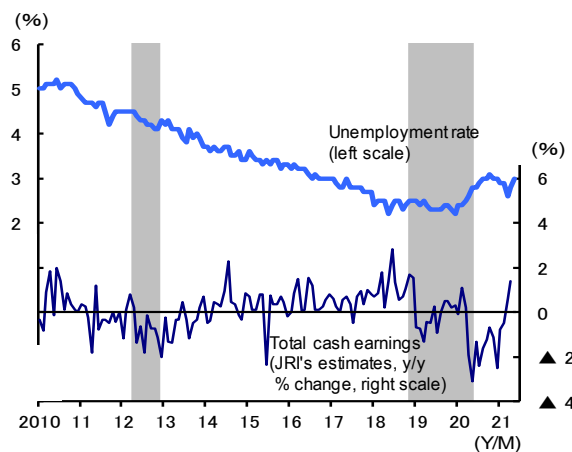
Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand
Both exports and imports are on a rising trend, albeit with fluctuations.



Source: The Bank of Japan.

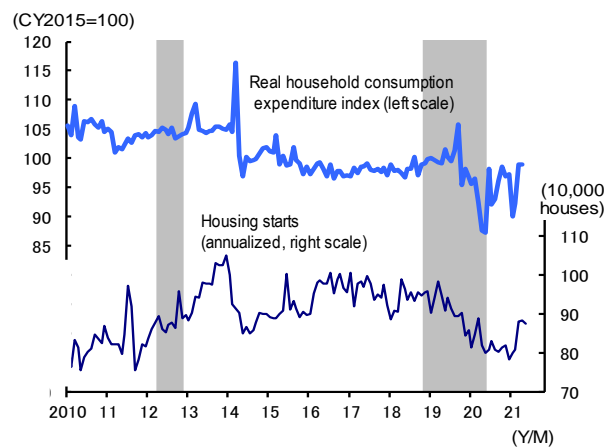
Figure 1-4 Employment and Income
The unemployment rate remained at around 3%.
Nominal wages increased for the second consecutive month.



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

* The shaded area indicates the recession phase.

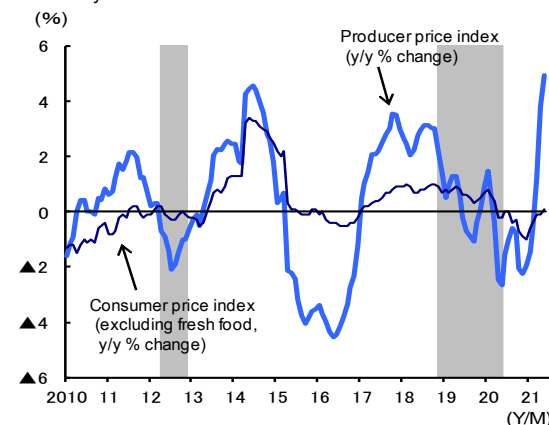
Figure 1-5 The Household Sector
Real consumption saw some ups and downs due to restrictions on activity. Housing starts remained at the low level of 800,000 units.



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 mainly for petroleum products. Consumer prices turned positive year on year.



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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Business Sentiment Has Been Polarized

◆ Business sentiment Improved Mainly for the Manufacturing Industry

In the Bank of Japan's June 2021 Tankan Survey, the DI for business conditions for large manufacturers was +14, up 9 percentage points from the previous survey and recording its highest level since the survey conducted in December 2018. While the DI deteriorated for automobile manufacturers due to the effect of the semiconductor component supply shortage, business sentiment for general-purpose machinery and electric machinery improved significantly on the back of increased exports reflecting the recovery of the overseas economy.

The DI for large nonmanufacturers was +1, recording its first positive value, albeit slight, in five quarters. Breaking it down by sector, while the DI remained brisk for telecommunications, information services and construction, it continued to deteriorate in negative territory for personal services and accommodation and food services, which suffered from the impact of COVID-19, highlighting visible

polarization among industries.

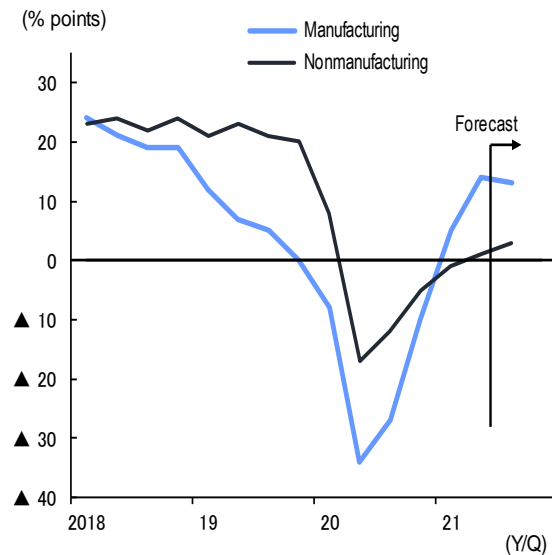
◆ Exports Remained on a Rising Trend

Real exports in May increased by 1.9% from the previous month, up for the third straight month. By region, exports to Europe and the United States, which had been temporarily sluggish, picked up due to the resumption of economic activities.

◆ Activity Restrictions Are Weighing on Personal Consumption

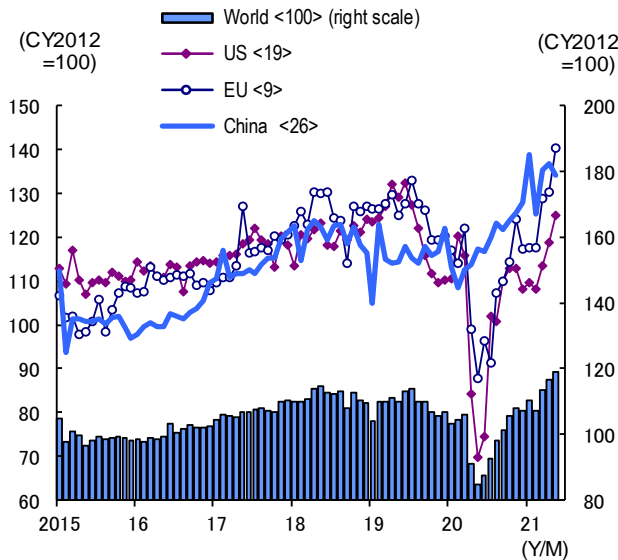
Japan's Real Consumption Activity Index (travel balance adjusted) for April 2021 declined by 0.7% from the previous month, down for the first time in two months. Service consumption decreased due to the growing tendency toward voluntary restraint on outings as a result of the reissuance of the state of emergency declaration, and consumption of nondurable goods was also sluggish, as department stores had been included in the scope of business closure requests.

Figure 2-1 Business Conditions DI by Industry in BoJ's Tankan Survey <large enterprises>



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

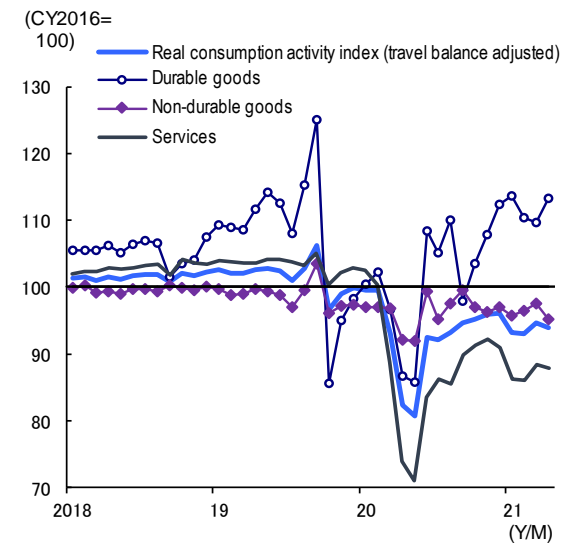
Figure 2-2 Real Exports by Destination <seasonally adjusted>



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

Note: 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.

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, an increase in shipments of electronic parts and devices was prominent, while shipments of capital goods also continued to increase. Looking at capital goods exports by region, the increasing trend has been accelerating for shipments to the EU and the United States, where activity restrictions have been eased, in addition to shipments to China, where the recovery in economic activity has been firm.

As for future prospects, increased demand for 5G-related products and a recovery in global demand for capital investment are expected to boost shipments of electronic parts and devices and capital goods. According to the Bank of Japan's June 2021 Tankan Survey, the DI for future overseas supply & demand conditions for products turned out to be positive in processing industries such as production machinery, indicating that many companies believe that overseas demand will continue to improve. Growth momentum for exports on the whole is expected to

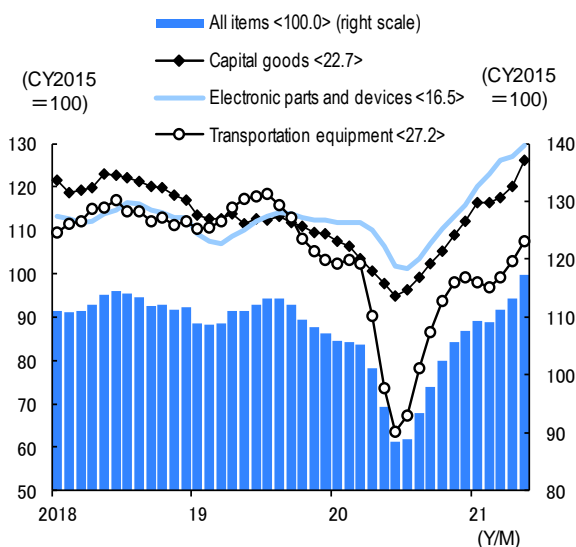
remain strong.

◆ Demand Related to Inbound Tourism Has Remained Virtually Nonexistent

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, a 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 only around 50% of the level prior to the COVID-19 outbreak. In Japan, given the current situation surrounding COVID-19 vaccinations, 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>

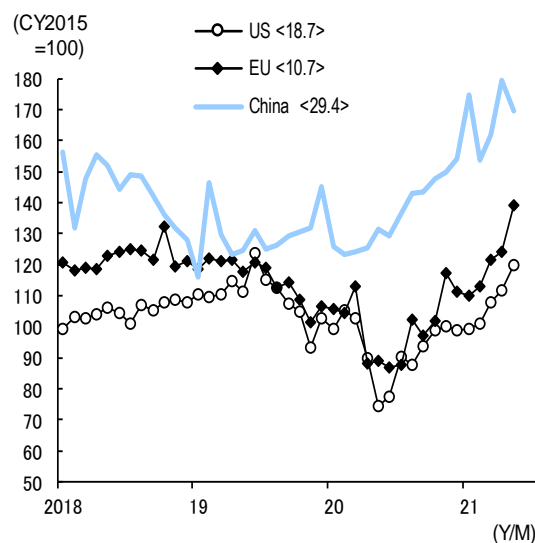


Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.

Note: 1. 3-month moving averages.

2. Figures in the angled brackets show the shares in total nominal exports in CY2020.

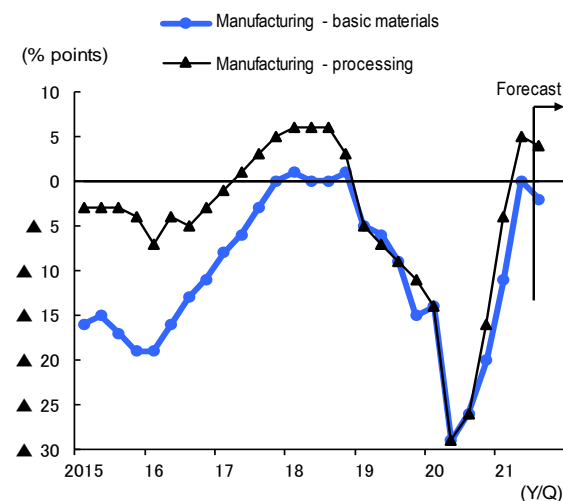
Figure 3-2 Real Exports of Capital Goods
by Country or Area
<seasonally adjusted>



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 of capital goods in CY2020.

Figure 3-3 DI for Overseas Supply and
Demand Conditions for Products
<large enterprises>



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

Note: The latest figures are forecasts based on June 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

According to the Financial Statements Statistics of Corporations by Industry, sales on an industry-wide basis for the January-March 2021 quarter increased 0.6% from the previous quarter, up for the third consecutive quarter. On the back of the increase in sales, current profits also increased 5.6% from the previous quarter, up for the third consecutive quarter. By industry, current profits in the manufacturing sector remained on a rising trend thanks to the recovery in exports, up 12.5% from the previous quarter. On the other hand, in the nonmanufacturing sector, while current profits on the whole increased from the previous quarter, the accommodation and food services industries, which have been greatly impacted by the COVID-19 pandemic, continued to record further losses.

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 non-manufacturing sector areas related to consumption will likely face extremely challenging earnings conditions for the foreseeable future due

to the effects of activity restrictions including the ongoing request for restaurants and bars to shorten their operating hours.

◆ Companies Have Resumed Capital Investment

Capital expenditure for the January-March 2021 quarter decreased 0.7% from the previous quarter on an industry-wide basis, down for the fourth consecutive quarter. By industry, capital expenditure in the manufacturing industry increased on the back of an improvement in the earnings environment, demonstrating moves to resume postponed investment activities. According to the Bank of Japan's June 2021 Tankan Survey, capital expenditure plans (large enterprises, industry-wide basis) for fiscal 2021 are 12.3% higher than actual results of the previous year, with the prospect of the level of investment recovering to pre-COVID-19 outbreak values. However, corporate investment stance varies among industries, and companies are expected to remain cautious about capital investment in industries such as accommodation and food services and personal services.

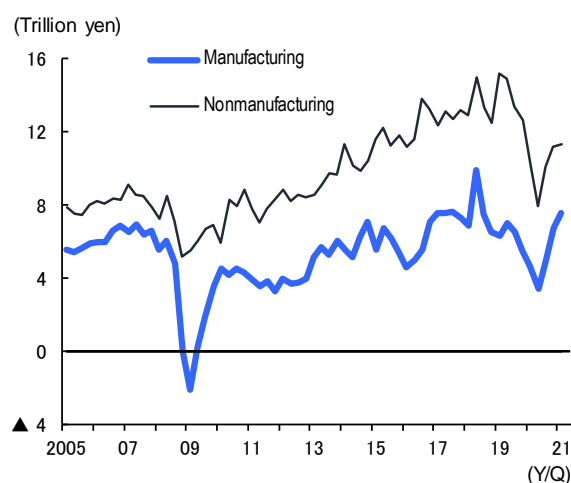
Figure 4-1 Sales Value of Japanese Corporations
<seasonally adjusted>



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

Note: All industries except for financial services and insurance.

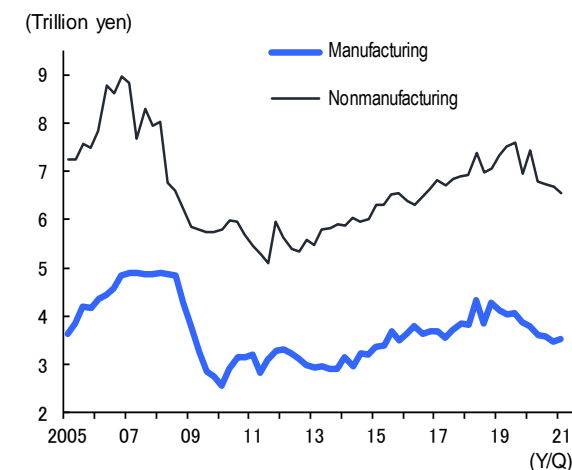
Figure 4-2 Current Profits of Japanese Corporations by Type
<seasonally adjusted>



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.

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

◆ The Number of People Leaving the Labor Market is Increasing

The unemployment rate in May 2021 was 3.0%, up for the second consecutive month and close to the peak level of 3.1% recorded in October 2020. Despite the active use of employment adjustment subsidies, the number of employed persons decreased due to the prolonged restrictions on activities.

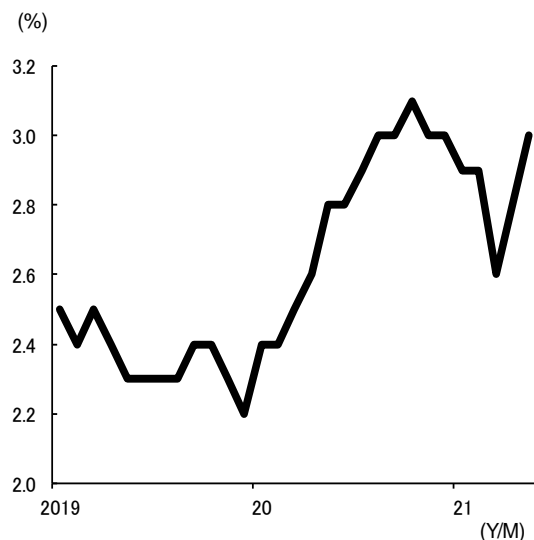
In addition, the actual employment situation has deteriorated more than official statistics indicate. In May, the non-labor force population grew by 170,000 people from the previous month, which pushed down the unemployment rate by 0.2 percentage points. As the demand for non-regular workers in food services and other industries has been sluggish due to repeated restrictions on activities, the number of latent unemployed persons leaving the labor market as a result of no longer actively seeking employment seems to have increased.

◆ The Lower Rate of Part-time Workers Boosted Average Wages

Total cash earnings (on the basis of common business establishments) in April 2021 rose 2.4% year-on-year, recording a year-on-year increase for the second consecutive month. This is a high growth rate in recent years, particularly for scheduled salaries. However, the increase was attributable primarily to the fact that average wages were boosted by a lower rate of part-time workers paid low-wages due to the effects of the COVID-19 pandemic; the actual pay situation has not been brisk.

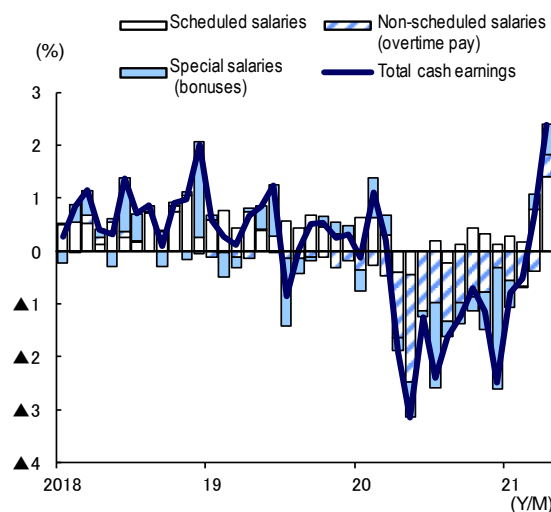
Meanwhile, this year's summer bonuses were reported to be sluggish, mainly at large companies. This is because the impact of deteriorated earnings in the previous fiscal year due to the COVID-19 pandemic was reflected in this year's summer bonuses at many large companies. Owing to the decline in special salaries (bonuses), it is difficult to expect that overall wages will improve in earnest for the foreseeable future.

Figure 5-1 Unemployment Rate
<seasonally adjusted>



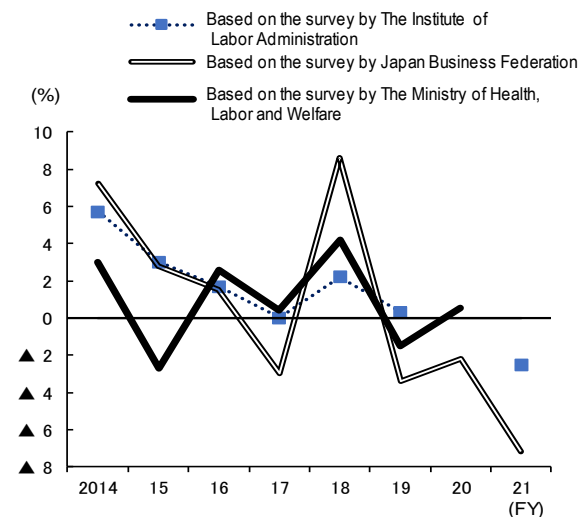
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

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 Summer Bonuses
<year-on-year % change>



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

Personal Consumption is Expected to Visibly Recover as COVID-19 Vaccines Become Widely Available

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

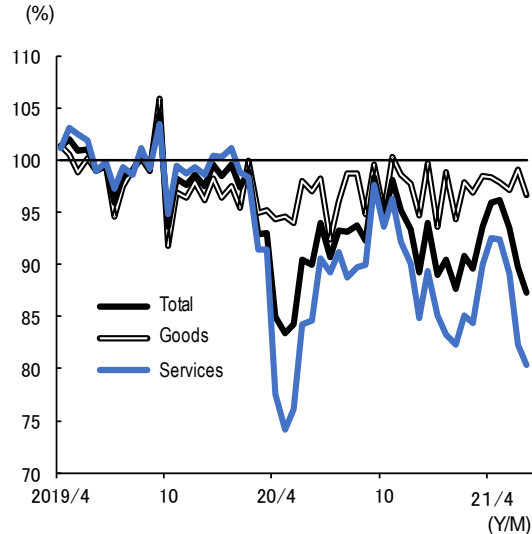
Consumption based on credit card settlements decreased toward the first half of June. Consumption has been up and down due to the repeated easing and reinforcement of restrictions on activities. Service consumption in particular has been greatly impacted by the effects of activity restrictions.

On the other hand, goods consumption has been supported by brisk sales of some luxury goods, including sales of art, jewelry and precious metals at department stores. As consumers voluntarily refrain from spending money on services in order to prevent COVID-19 infections, funds to be used for such purposes seem to have shifted toward the consumption of luxury goods. Meanwhile, unrealized market valuation gains on stocks and other securities for the January-March 2021 period increased by 50 trillion yen from the previous year in the household sector as a whole, which also reflected the positive effects of higher stock prices on assets.

◆ Recovery in Consumption Will Not Become Clear Until This Autumn

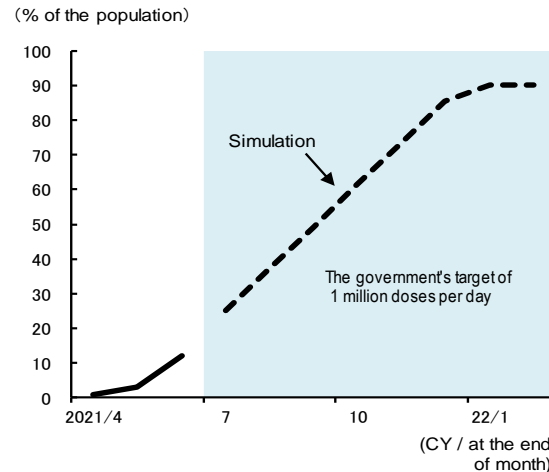
As for future prospects, restrictions on activities aimed at curbing the spread of COVID-19 are expected to remain in place, putting the brakes on consumer spending. Recently, however, progress has been made in the COVID-19 vaccine rollout, which is the key to normalizing consumption activities. If the government's target of 1 million doses per day is achieved, 70% of the population will be vaccinated with two doses by the end of November, which is believed to be a requirement for acquiring herd immunity. COVID-19 related savings, or the money which has not been spent on household expenses due to self-restraint in consumption activities, are estimated to have accumulated to about 300,000 yen on average for working households and 450,000 yen for retired households. Given this situation, it is predicted that the recovery in consumption will become clear after this autumn, when rollout of the vaccine programs progresses to a certain level.

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.

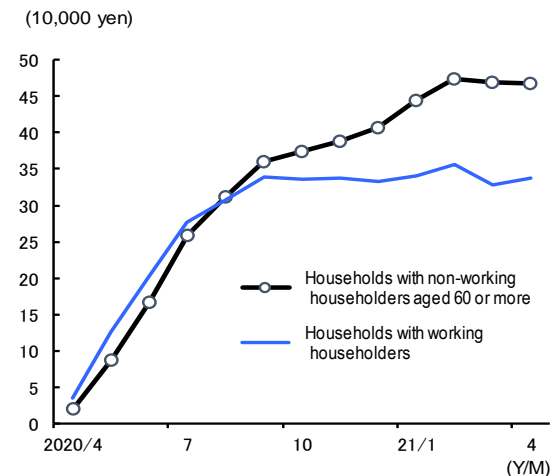
Figure 6-2 Percentage of the Population Who Was or Will Be Vaccinated with Two Doses



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labor and Welfare, Prime Minister's Office of Japan.

Note: 90% is the upper limit because the people aged 11 or less are not included in the target..

Figure 6-3 COVID-19 Related Savings per Household by Type



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note: Households with 2 or more household members.

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Topic: An Epic Shortage of Lumber Depresses Housing Starts

◆ The Lumber Shortage is Affected by Both Supply and Demand

Due to an unprecedented lumber shortage, lumber prices are skyrocketing worldwide. The supply-demand balance of lumber used for pillars and beams in houses has tightened, and lumber futures rose five-fold compared to before the COVID-19 outbreak.

The lumber shortage was caused by factors on both the supply and demand sides. On the demand side, it is possible to point to the brisk housing market in the United States. The number of housing starts, which fell immediately in the wake of the COVID-19 pandemic, began to show a sharp recovery, remaining at a high level surpassing pre-coronavirus levels by more than 30%. Housing demand has been boosted by low interest rates on housing loans as a result of monetary easing.

On the supply side, the lumber industry in the United States is experiencing a labor shortage. The number of employees in the logging industry has been on a downward trend since the mid-2010s, and is currently at a level 16% lower than its most recent

peak. The decline in supply capacity has led to tighter supply-demand conditions and soaring prices.

◆ The Lumber Shortage is Placing Downward Pressure on Housing Starts in Japan

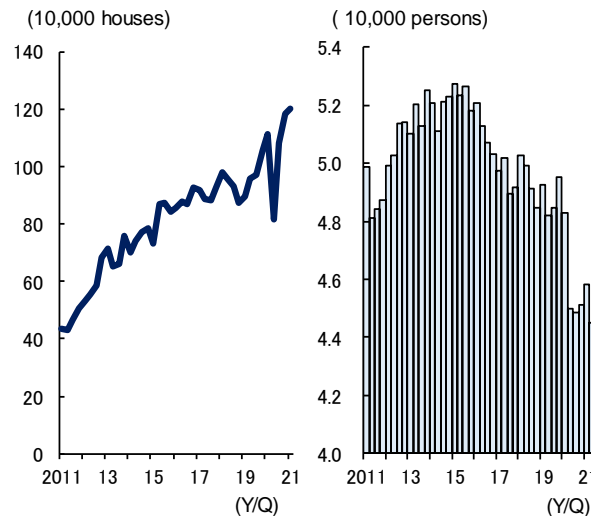
The unprecedented lumber shortage has had ripple effects in Japan. Prices of lumber imports have soared since last autumn. Given the leading nature of futures prices, import prices may rise further in the future. A shortage of lumber imports is also expected. In fact, the Forestry Agency expects the supply of laminated wood products (lumber used for pillars and beams for houses) to decrease by 4.5% from the previous year in the first half of the current fiscal year. It is estimated that housing starts in the first half of the current year will decline by 57,000 units from the previous year (down 13.7% from the previous year) due to a shortage of materials. In such a case, Japan's GDP would decline by 540.0 billion yen due to a decrease in housing investment.

Figure 7-1 Lumber Prices
<CME future>



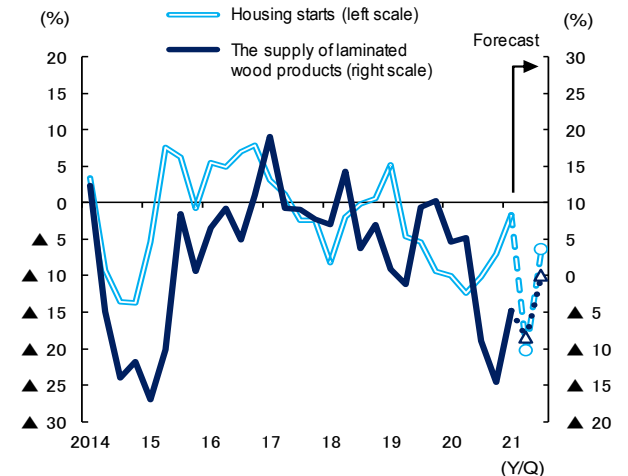
Source: The Japan Research Institute, Ltd. based on data of Bloomberg L.P.

Figure 7-2 U.S. Housing Starts and Number of Employees in Logging Industry
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of U.S. Census Bureau, U.S. BLS.

Figure 7-3 Housing Starts and Supply of Laminated Wood Products
<year-on-year % change>



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

Note: Forecast by JRI.

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Prospects for Japan's Economy - Projected Real GDP Change; 3.9% for FY2021 and 2.5% for FY2022

◆ Japan's GDP Is Expected to Recover to Its Peak Level Seen Prior to the COVID-19 Outbreak in the April-June 2022 Period

(1) Economic Recovery Will Become Clear in the Second Half of FY2021

Looking ahead, Japan's exports and capital investment are expected to remain firm on the back of the recovery of overseas economies, and Japan's GDP is expected to continue growing in positive territory. For the time being, however, the government's measures to curb the spread of COVID-19, such as continuing to request restaurants and bars to shorten their operating hours, will put economic recovery on the back burner.

Despite the foregoing, COVID-19 vaccinations, which are the key to the normalization of consumption, are progressing, and it is expected that elderly people who wish to receive a vaccine will obtain their second dose by the end of July. Personal consumption is expected to recover gradually if the vaccines are widely distributed to the elderly, who have been particularly cautious concerning spending. Personal consumption will increase by more than 4% if consumer activity returns to normal and the propensity to consume returns to pre-coronavirus levels. Therefore, it is anticipated that Japan's economy will grow at a relatively high rate by the second half of fiscal 2021, when more people are vaccinated and consumption shifts toward normalization.

By the beginning of fiscal 2022, however, the pace of economic recovery will likely return to a steady state as consumer spending mostly becomes normalized. As a result, quarterly growth is expected to slow significantly.

(2) Japan's GDP Growth for FY2021 Will be +3.9%

Japan's growth rate for FY2021 and FY2022 is expected to be +3.9% and +2.5%, respectively, with the prospect of achieving higher positive growth for two consecutive years. It is forecast that Japan's GDP will recover to the peak level seen prior to the COVID-19 outbreak (July-September 2019 period) in the April-June 2022 period.

◆ Prices Rose for the First Time in 10 Months

(3) In May 2021, core CPI increased 0.1% year on year, up for the first time in 10 months, reflecting the rise in energy prices. Excluding the effects of this rise, however, core CPI dropped 0.2% year on year, down for two consecutive months, against the backdrop of the decline in communications costs reflecting lower mobile phone charges, among other factors.

As for the future outlook, while energy prices are expected to continue to increase, there will be strong downward pressure on general prices from the viewpoint of supply and demand, and communications costs are anticipated to continue to decline. Consequently, CPI excluding fresh food and energy will likely hover around zero for the time being.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of July 7, 2021)

	(seasonally adjusted, annualized % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2020			CY2021			CY2022				CY2023	FY2020	FY2021	FY2022
	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)
	(Actual)		(Actual)	(Projection)			(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Actual)	(Projection)	(Projection)
Real GDP	22.9	11.7	▲ 3.9	1.4	3.6	5.2	5.1	1.1	1.1	0.9	0.9	▲ 4.6	3.9	2.5
Private Consumption Expenditure	22.0	9.0	▲ 5.8	▲ 0.2	4.7	8.0	7.6	0.6	0.8	1.0	1.0	▲ 6.0	3.5	3.1
Housing Investment	▲ 21.0	0.2	4.9	3.9	▲ 2.6	0.5	3.5	3.1	1.9	0.2	0.0	▲ 7.1	0.2	1.7
Business Fixed Investment	▲ 8.1	18.3	▲ 4.6	5.9	4.4	4.4	4.0	3.5	3.5	2.5	2.5	▲ 6.9	3.8	3.5
Private Inventories (percentage points contribution)	(▲ 0.8)	(▲ 2.0)	(1.7)	(▲ 0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.2)	(▲ 0.0)	(0.0)
Government Consumption Expenditure	12.0	7.3	▲ 4.5	1.5	2.1	0.8	1.0	0.6	0.4	0.4	0.4	3.2	1.7	0.7
Public Investment	3.4	5.3	▲ 2.1	▲ 0.8	0.0	0.4	0.2	0.0	▲ 0.2	▲ 0.4	0.2	4.3	0.3	0.0
Net Exports (percentage points contribution)	(11.2)	(4.2)	(▲ 0.9)	(0.4)	(▲ 0.0)	(0.1)	(0.1)	(▲ 0.0)	(▲ 0.0)	(▲ 0.1)	(▲ 0.1)	(▲ 0.6)	(1.0)	(0.0)
Exports of Goods and Services	32.5	55.7	9.2	11.8	4.8	5.7	5.7	4.6	4.6	3.9	3.9	▲ 10.5	14.2	4.8
Imports of Goods and Services	▲ 29.0	20.7	16.5	9.8	4.9	5.2	5.2	4.8	4.8	4.5	4.5	▲ 6.9	7.5	4.9
(Ref.) Domestic Private Demand (percentage points contribution)	(7.8)	(5.3)	(▲ 2.0)	(0.7)	(3.1)	(5.0)	(4.8)	(1.0)	(1.1)	(0.9)	(0.9)	(▲ 4.8)	(2.4)	(2.3)
(Ref.) Public Demand (percentage points contribution)	(2.8)	(1.8)	(▲ 1.0)	(0.3)	(0.5)	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.9)	(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	FY2020	FY2021	FY2022
Nominal GDP	▲ 4.5	▲ 0.8	▲ 1.7	6.7	2.1	1.0	4.0	4.3	3.6	2.2	1.1	▲ 3.9	3.4	2.8
GDP deflator	1.2	0.2	▲ 0.1	▲ 0.9	▲ 0.9	▲ 0.4	0.3	0.6	0.4	0.2	0.1	0.6	▲ 0.5	0.3
Consumer Price Index (excluding fresh food)	▲ 0.2	▲ 0.9	▲ 0.4	0.1	0.3	1.1	0.6	0.8	0.5	0.4	0.4	▲ 0.4	0.5	0.5
(excluding fresh food, consumption tax, education free of charge)	▲ 0.5	▲ 0.9	▲ 0.3	0.1	0.3	1.1	0.6	0.8	0.5	0.4	0.4	▲ 0.5	0.5	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	112	113	113	112	111	112	113	106	112	112
Import Price of Crude Oil (US\$/barrel)	41	44	55	67	73	69	67	69	70	68	68	43	70	69

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.