

Monthly Report of Prospects for Japan's Economy

March 2022

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 February 2022 issue of the original Japanese version.

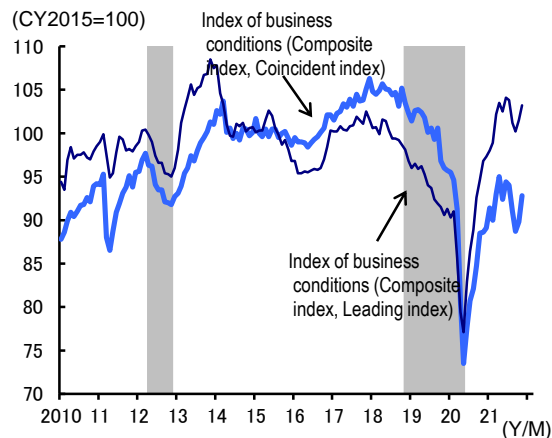
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The General Situation – There Have Been Signs of Economic Recovery

Figure 1-1 Economic Activity

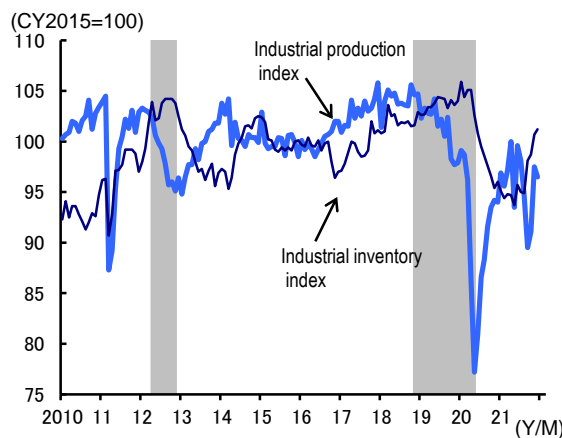
Both the CI coincident index and the CI leading index rose.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

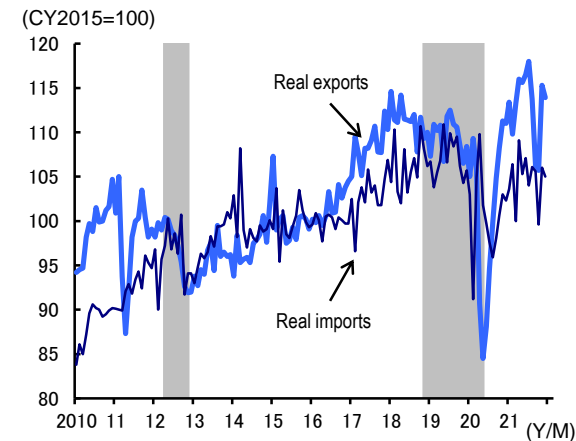
Industrial production rebounded mainly in the automobile industry.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

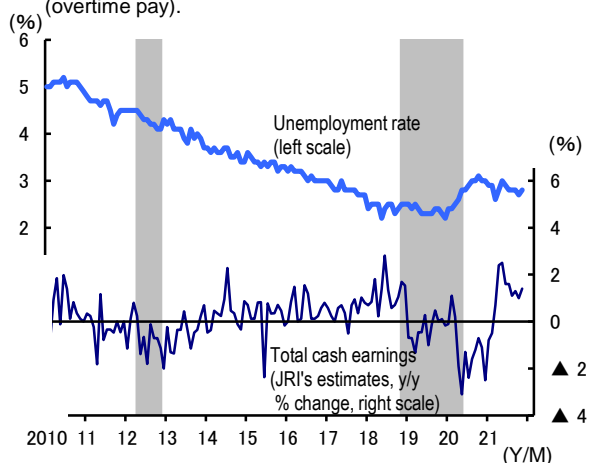
Both exports and imports saw signs of recovery from a significant decline.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate remained at 2% in the latter half. Nominal wages increased, mainly for non-scheduled salaries (overtime pay).

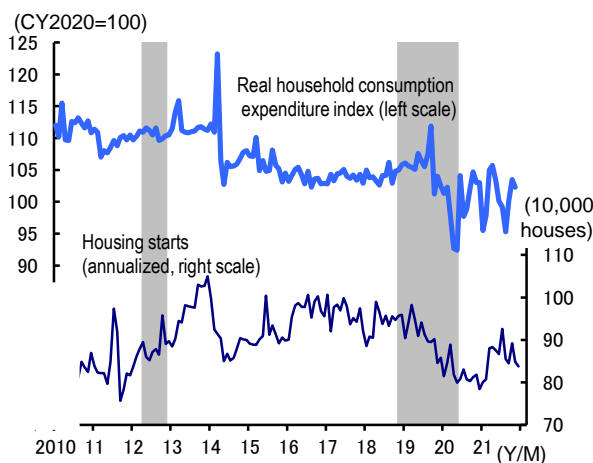


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

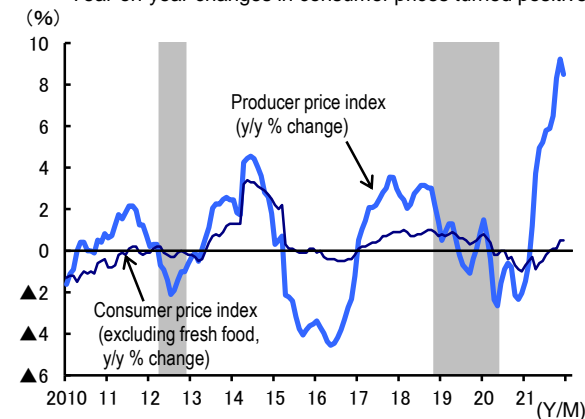
Real consumption picked up toward the end of 2021. Housing starts remained sluggish.



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 saw their highest growth, mainly for petroleum products. Year-on-year changes in consumer prices turned positive.



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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While Production and Consumption Picked up, Private Spending Remained Stagnant

◆ Business Sentiment Improved Toward Year-end

Japan's economy remained on a recovery trend until the end of 2021. The DI for current business conditions in the Economy Watchers Survey for December 2021 rose for four consecutive months, recording its highest level since October 2018. Looking at the breakdown, household activity-related DI continued to improve, and corporate activity-related DI remained at a high level.

◆ Production and Exports Are Expected to Pick up

The Industrial Production Index for December 2021 declined 1.0% from the previous month, down for the first time in three months. As the recovery in production activities paused, the Export Volume Index for December 2021 also declined month-over-month for the first time in three months.

Meanwhile, regarding future production plans, production is expected to increase by 5.2% month-over-month in January 2022, and by 2.2% month-over-month in February 2022, indicating continuing recovery in production activities in the

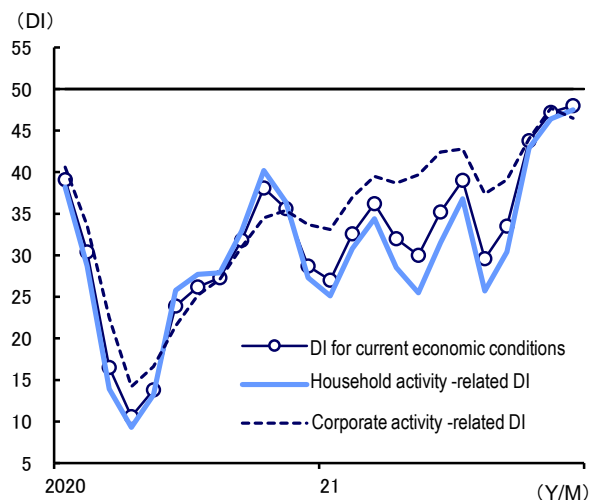
manufacturing industry. As production activities pick up, the rising trend of exports will likely become clearer. However, as some companies have decided to suspend their plant operations temporarily due to the spread of the coronavirus Omicron variant, there is a risk that production plans will be revised downward.

◆ Consumer Sentiment Has Deteriorated Since the Beginning of This Year

Personal consumption continued to pick up toward the end of the previous year as Japan's Real Consumption Activity Index (travel balance adjusted) for November 2021 rose from the previous month, up for the three consecutive months.

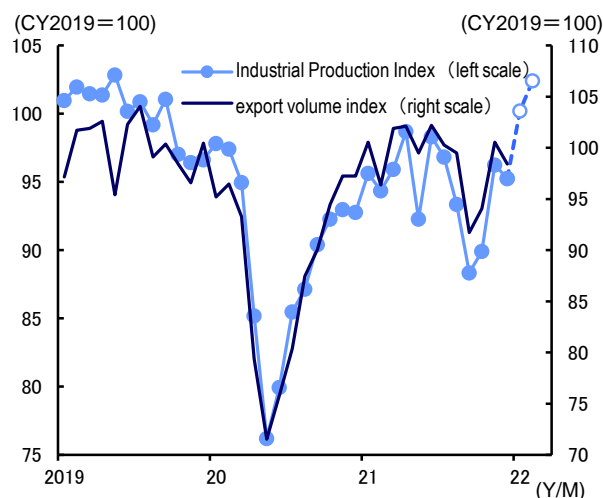
On the other hand, the Consumer Confidence Index for January 2022 declined significantly from the previous month, plunging to a low level for the first time in five months. Due to the spread of the Omicron variant, consumers have become more cautious about spending since the beginning of the new year.

Figure 2-1 Economy Watchers Survey
<seasonally adjusted>



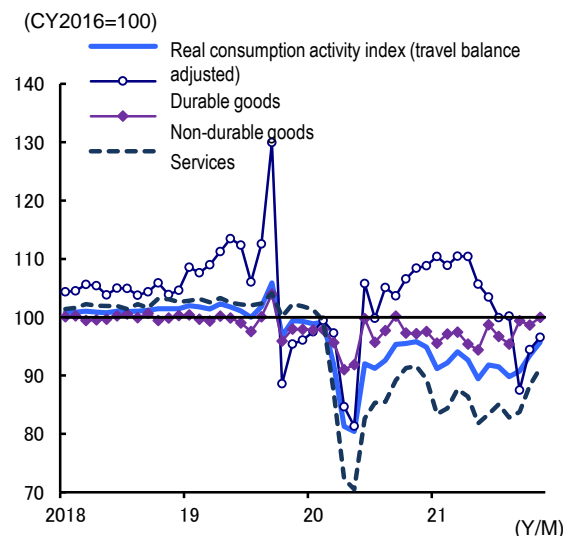
Source: The Japan Research Institute, Ltd. based on data of The
of the Cabinet Office.

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



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

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 Have Picked up

◆ Exports of Capital Goods Remained Sluggish

Goods exports for December 2021 decreased 0.2% from the previous month, recording a slight decline month-over-month. By item, while shipments of transportation machinery continued to pick up, the pace of recovery slowed from the previous month. In addition, shipments of capital goods remained sluggish, mainly to Europe and China. This was attributable primarily to the postponement of capital investment by local companies due to stagnant production activities as a result of the shortages in components and electricity.

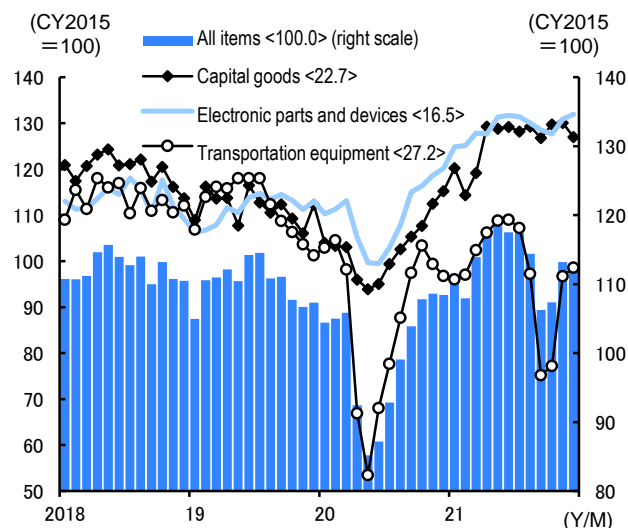
As for future prospects, exports of transportation machinery are expected to remain on a rising trend in line with the recovery of domestic automobile production, and exports of capital goods are also anticipated to pick up sooner or later. Looking at Manufacturing PMI of the U.S., China and Europe, future production outlook has been improving, indicating that the shortages in components and electricity are gradually becoming resolved. Local companies' appetite for capital investment is

also anticipated to improve, reflecting the recovery in production activities. However, as it is difficult to deny the possibility that restrictions on economic activities will increase in various countries around the world due to the spread of the Omicron variant, attention must be paid to the risks that overseas demand will decline and stagnant supply chains will put downward pressure on exports.

◆ Demand Related to Inbound Tourism Has Remained Virtually Nonexistent

The number of tourists who visited Japan in December 2021 fell 99.5% compared to the same month in 2019. Amid concerns about the further spread of COVID-19 triggered by introduction of the virus from overseas, the Japanese government maintained its border restrictions by banning the new entry of foreign nationals into Japan, in principle. It will likely take time to ease the border restrictions for international tourists, and thus, demand related to inbound tourism is expected to remain virtually zero for the foreseeable future.

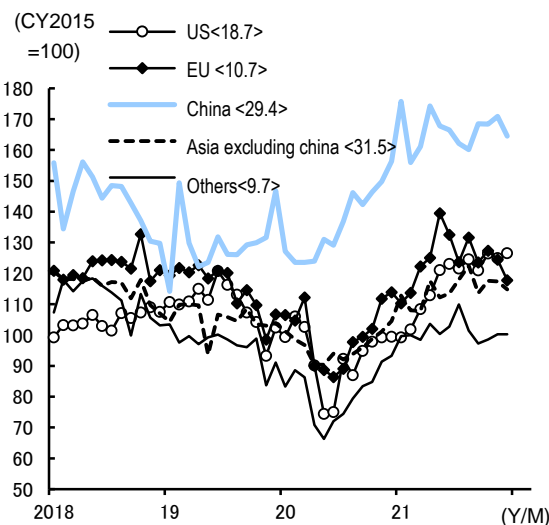
Figure 3-1 Real Exports by Item
<seasonally adjusted>



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

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

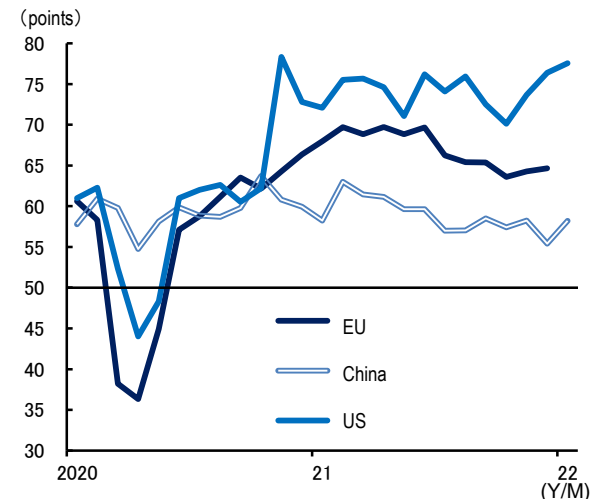
Figure 3-2 Real Exports of Capital Goods by Country or Area
<seasonally adjusted>



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

Note: Figures in the angled brackets show the shares in total nominal exports of capital goods in CY2020.

Figure 3-3 US, China, EU Manufacturing PMI
<production outlook>



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

Both Corporate Earnings and Business Fixed Investment Are Expected to Pick up

◆ Corporate Earnings Were Sluggish

According to the Financial Statements Statistics of Corporations by Industry, current profits on an industry-wide basis for the July-September 2021 quarter decreased for the first time in five quarters, as supply chain stagnation and extension of the state of emergency declaration weighed on profits. However, in the October-December 2021 quarter, both the manufacturing and nonmanufacturing industries seem to have posted profits on the back of the alleviation of supply shortages for components and raw materials and the recovery of personal consumption in line with the lifting of the state of emergency declaration.

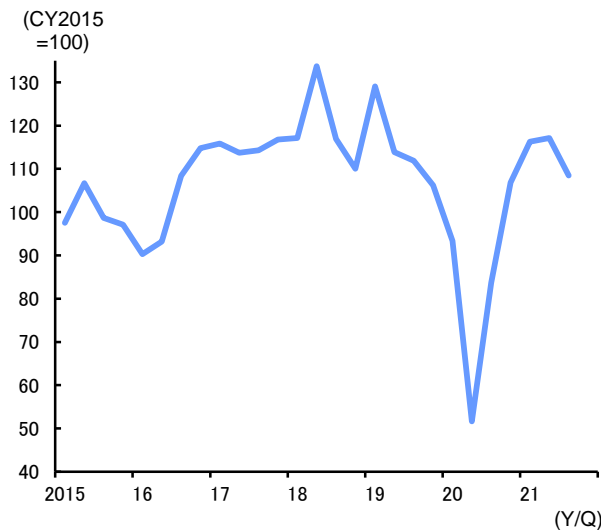
Looking ahead, earnings from the manufacturing industry are expected to continue to improve against the backdrop of the further easing of supply constraints as well as an increase in exports. The pace of improvement in earnings, however, will likely remain moderate due to the negative effects of soaring raw materials prices mainly for downstream industries that cannot easily pass on cost increases. On the other

hand, the severe business environment is anticipated to continue for the non-manufacturing industry, particularly accommodation and lifestyle-related services industries, which have been significantly affected by the spread of the Omicron variant.

◆ Capital Investment is Expected to Rebound

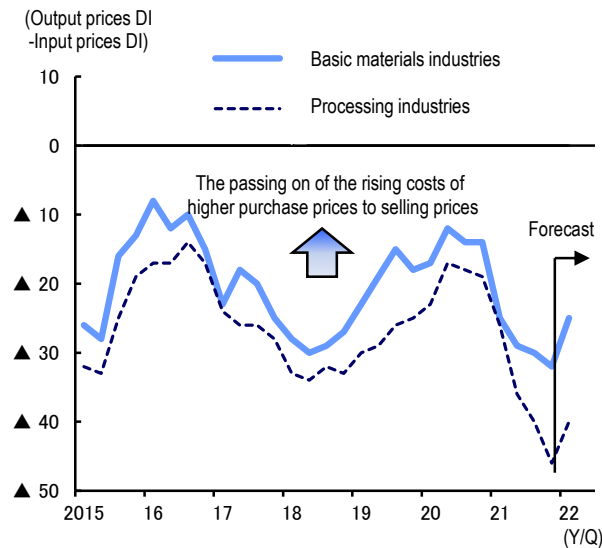
Business fixed investment has picked up. While many companies decided to temporarily postpone their capital investment due to the prolonged state of emergency declaration, among other factors, machinery orders and construction work orders, which are leading indices for capital investment, have been increasing since the fall of 2021. It is clear from the fixed investment plan in the Bank of Japan's December 2021 Tankan Survey that large enterprises are maintaining their aggressive investment stance. Although there are concerns over the negative effects of the Omicron outbreak, the corporate investment appetite for digitization and other measures remains strong, and capital investment is expected to rebound in the future.

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



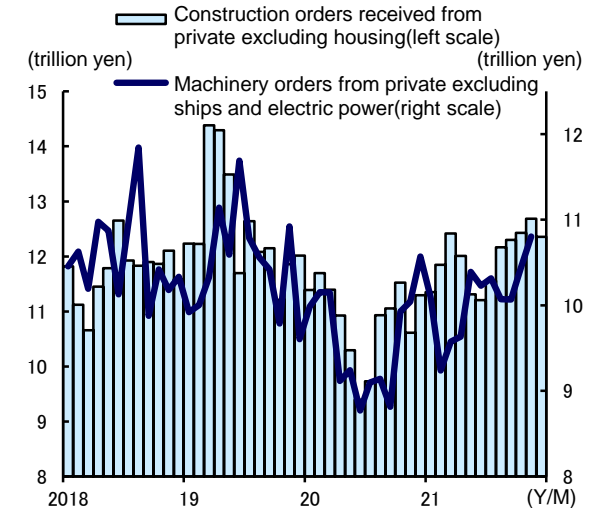
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 4-2 Current Situation of Passing on of Costs of Higher Purchase Prices
<manufacturing Industry>



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

Figure 4-3 Machinery Orders and Construction Orders
<annualized, seasonally adjusted>



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

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The Consumption Downturn Due to the COVID-19 Resurgence is Expected to be Short-lived

◆ Consumer Spending Has Weakened Again

While personal consumption of both goods and services picked up toward the end of the previous year, it seems that private spending has once again weakened due to the spread of the Omicron variant and the subsequent issuance of the priority preventive measures to control the spread of COVID-19. Since the beginning of the new year, the number of people visiting retail and entertainment facilities has plunged, and automobile sales in January 2022 declined month-over-month for the first time in four months.

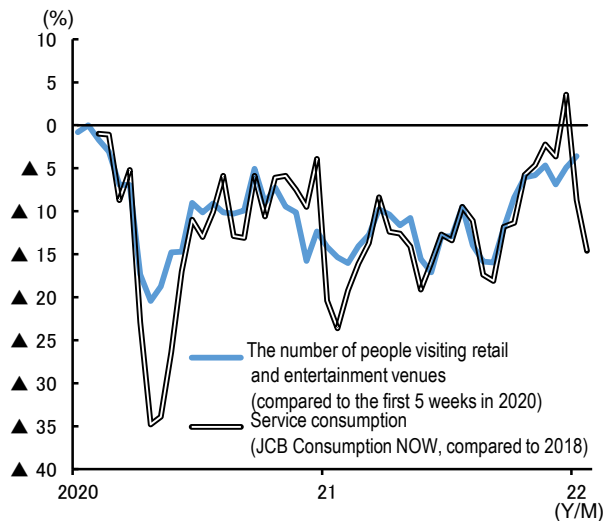
◆ Consumption Will Likely Rebound as the Number of New COVID-19 Cases Declines

The spread of the Omicron variant is expected to weigh on consumption recovery for the foreseeable future. In addition to the expansion of self-restraint on outings due to an increase in the number of regions subject to the priority preventive measures to control the spread of COVID-19, automobile production cuts and suspension of operations by stores in line with an increase in the number of

workers forced to isolate at home due to being COVID positive or a close contact of a COVID positive individual will likely put downward pressure on private spending from the supply perspective. In addition, concerns over inflation due to the rise in gasoline prices and other factors may dampen consumer sentiment.

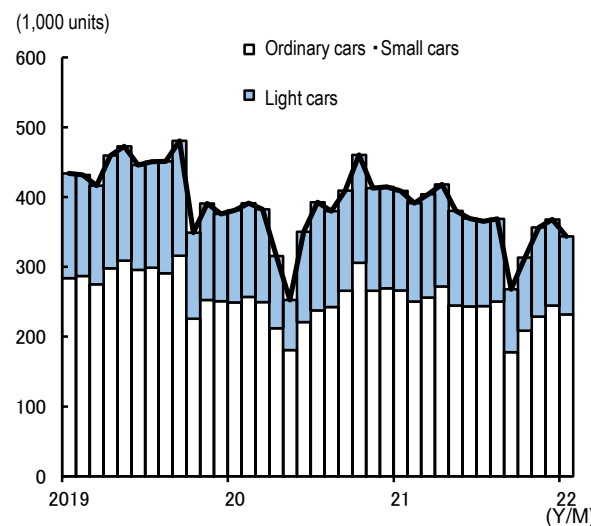
Although the future outlook of COVID-19 remains uncertain, the number of new Omicron cases has declined within a short period of time in other countries. In the main scenario, it is expected that the number of new cases will soon peak out in Japan and the priority preventive measures to control the spread of COVID-19 will be lifted as per the government's schedule. In such a case, private consumption will likely return to a recovery phase once again. Nevertheless, there is a possibility that consumers will remain cautious about spending even after the spread of COVID-19 has been contained. Therefore, it is difficult to expect a rapid increase in consumption via active use of the excess savings that accumulated due to the COVID-19 pandemic as a result of voluntary restraint by consumers on eating out and travelling.

Figure 5-1 Consumption Based on Credit Card Settlements <compared to the same month in 2018>



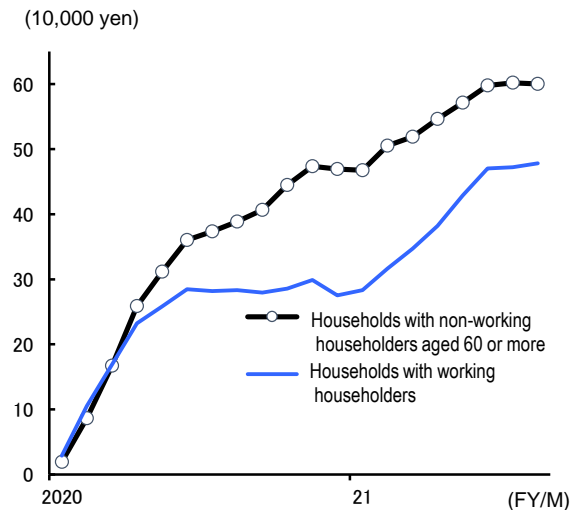
Source: The Japan Research Institute, Ltd. based on data of JCB Consumption Now, Google.

Figure 5-2 New Vehicle Registrations <annualized, seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of National Federation of Mini Vehicle Associations, The Automobile Dealers Association of Japan.

Figure 5-3 COVID-19 Related Savings per Household by Type in 2020



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

Topic: The Short-Term Benefits of Wage Increases Will Be Limited

◆ Wage Hikes Will Become a Policy Issue

Total cash earnings (on the basis of common business establishments) in November 2021 were up 1.8% year on year, showing a weak recovery from the previous year's decline and a continued severe environment surrounding wages. Under these circumstances, the government announced that 1) it would expand tax breaks for companies that raise wages, 2) it would give preferential treatment regarding government procurement to companies that raise wages, and 3) it would raise the official prices of care, childcare, and nursing services which will lead to wage increases.

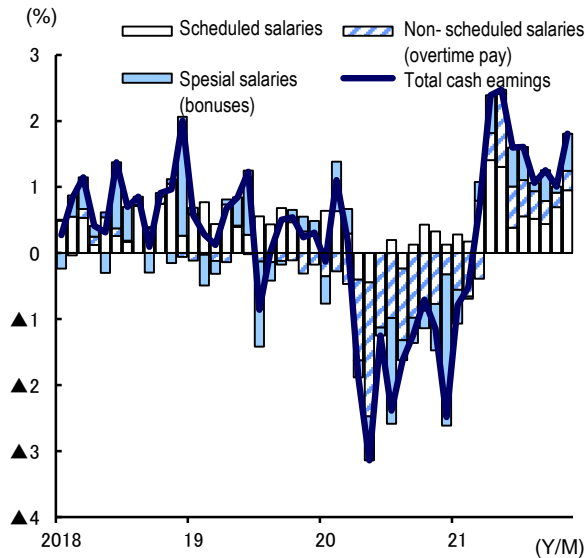
In recent years, the labor share has remained at the same level as in the 1980s. The main reason for stagnant wages is the faltering ability of companies to create added value, and in turn, labor productivity, rather than the low labor share. For this reason, policies such as those listed in 1) and 2) above that encourage an increase

in the labor share rate could have side effects such as widening corporate disparities and declining productivity due to restraint on investment. In addition, the increase in the official prices mentioned in 3) above may not be adequately passed on to caregivers, childcare workers and nurses, the original subjects of the wage increase, because management would receive the additional compensation.

◆ Wage Increases Will Take Time

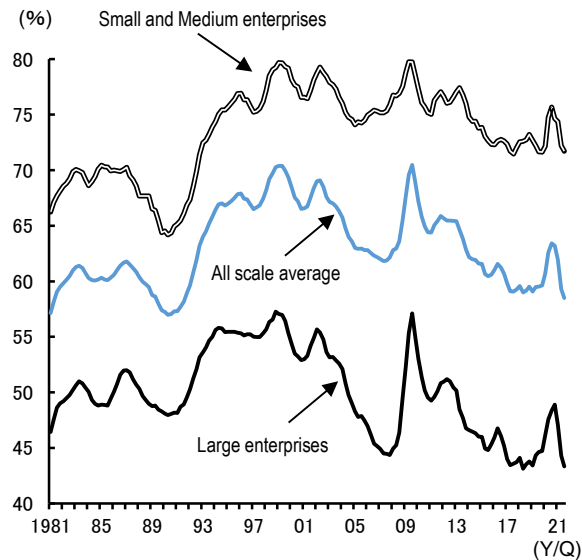
In terms of wage hikes, it is necessary to promote a growth strategy that supports the improvement of corporate productivity in the face of a declining population, and to make effective efforts to ensure that employees in the three fields of care, childcare, and nursing services, which have become increasingly important amid the COVID-19 pandemic, can realize higher wages. It will take some time for public and private initiatives to translate into higher wages.

Figure 6-1 Contributions to Change Rate of Nominal Wages



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

Figure 6-2 Labor's Share by Company Size <4-period moving averages>

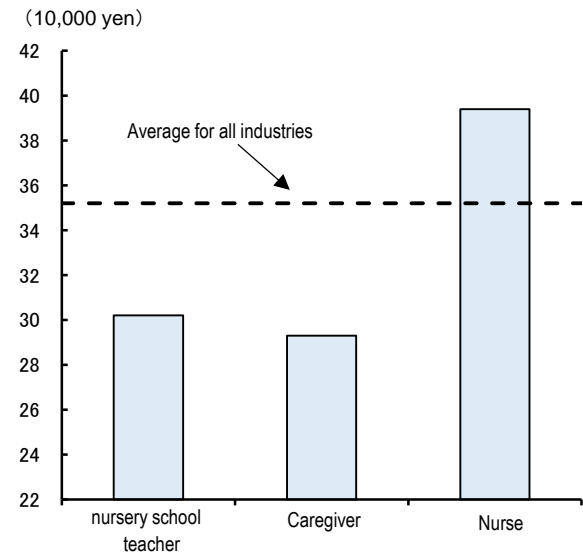


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of finance.

Note1: Labor Cost / Value Added.

Note2: Small and medium enterprises are capitalized between

Figure 6-3 Average Monthly Earnings of General Workers by Occupation



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

Note: Excluding executives and part-time workers.

Prospects for Japan's Economy - Projected Real GDP Change; 2.5% for FY2021 and 3.3% for FY2022

◆ Full-fledged Economic Recovery Is Expected to Be Delayed Until Spring 2022 and Thereafter

(1) Japan's real GDP for the October-December 2021 period was +5.4% on an annualized quarter-on-quarter basis (up 1.3% from the preceding quarter), marking the first positive growth in two quarters. This indicates that the Japanese economy temporarily rebounded toward the end of last year. The lifting of the state of emergency declaration resulted in a significant increase in service consumption, and the recovery in automobile production in line with the alleviation of the component shortage also contributed to boosting Japan's real GDP.

(2) Despite the foregoing, since the beginning of this year, downward pressure on the economy has been increasing due to the spread of the Omicron variant and the subsequent issuance of the priority preventive measures to control the spread of COVID-19. Service consumption in the January-March 2022 period is expected to decline due to a resurgence of the tendency toward self-restraint. In addition, there are companies that are forced to suspend plant operations as a result of an increase in the number of COVID-19 cases and close contacts.

While there have been signs that the Omicron wave has passed its peak and manufacturing production is anticipated to pick up, reflecting the easing of supply constraints, it is unlikely to be strong enough to boost the economy. For this reason, Japan's real GDP growth for the January-March 2022 period will likely slow to around 1%.

(3) After the April-June 2022 period, service consumption is expected to return to an increasing trend as activity restrictions will be eased in line with the decline in new COVID-19 cases. As the recovery of production activities in the manufacturing industry boosts exports and capital investment, Japan is likely to achieve high positive growth. However, it is hard to exclude the risk of a delay in economic recovery and possible economic downturn due to prolonged effects of the Omicron

wave and the emergence of new COVID-19 variants in the future.

(4) Japan's growth rate forecast for FY2021 and FY2022 is +2.5% and +3.3%, respectively. After recording high positive growth for two consecutive years backed by the recovery of economic activity from the COVID-19 pandemic, the growth rate for FY2023 is expected to be +1.3%, indicating that the pace of growth will slow significantly as economic activity is normalized. It is forecast that Japan's real GDP will recover to its pre-COVID-19 peak in the October-December 2022 period.

◆ Consumer Prices Rose for the Fourth Consecutive Month

(6) In December 2021, core CPI increased 0.5% year on year, up for the fourth consecutive month. While mobile phone charges continued to decline significantly, the rise in energy prices boosted the overall CPI.

Despite growing concerns over inflation against the backdrop of soaring resource prices, companies remain cautious about passing on cost increases, and the increase in product prices is expected to be limited to select items such as energy and food. Consequently, core CPI growth is expected to be limited to around +1% even after April when the decline in mobile phone charges will diminish.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of February 15, 2022)

	(seasonally adjusted, annualized % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2021		CY2022				CY2023				CY2024	FY2021	FY2022	FY2023
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)	(Projection)
	(Actual)	(Projection)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	▲ 2.7	5.4	1.0	6.5	3.5	1.5	1.2	1.1	1.1	0.9	0.9	2.5	3.3	1.3
Private Consumption Expenditure	▲ 3.7	11.2	0.0	6.2	3.1	1.2	1.2	1.0	1.0	0.8	0.8	2.8	3.5	1.2
Housing Investment	▲ 6.3	▲ 3.7	3.0	5.8	3.5	1.5	0.0	0.2	0.2	0.0	0.0	▲ 1.0	2.0	0.5
Business Fixed Investment	▲ 9.2	1.6	4.2	8.9	6.5	4.3	2.8	2.6	2.6	2.4	2.4	1.3	4.6	3.0
Private Inventories (percentage points contribution)	(0.4)	(▲ 0.5)	(0.0)	(0.6)	(0.4)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(0.2)	(0.0)
Government Consumption Expenditure	4.4	▲ 1.3	1.4	2.8	0.4	1.0	0.4	0.2	0.2	0.2	0.2	1.9	1.3	0.4
Public Investment	▲ 11.4	▲ 12.4	2.0	7.8	4.7	▲ 2.1	▲ 1.5	0.2	0.6	0.8	0.4	▲ 7.3	0.6	0.0
Net Exports (percentage points contribution)	(0.4)	(0.8)	(▲ 0.2)	(▲ 0.2)	(▲ 0.1)	(▲ 0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.0)	(▲ 0.0)	(1.0)	(0.0)	(▲ 0.0)
Exports of Goods and Services	▲ 1.1	3.9	3.0	5.4	3.8	3.4	3.4	3.0	3.0	2.6	2.6	12.6	3.7	3.1
Imports of Goods and Services	▲ 3.7	▲ 1.1	3.9	6.1	4.2	3.4	3.2	2.7	2.7	2.6	2.6	6.3	3.3	3.0
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 3.4)	(5.4)	(0.8)	(5.7)	(3.3)	(1.4)	(1.1)	(1.0)	(1.0)	(0.8)	(0.8)	(1.6)	(2.9)	(1.2)
(Ref.) Public Demand (percentage points contribution)	(0.2)	(0.8)	(▲ 0.2)	(▲ 0.2)	(▲ 0.1)	(▲ 0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.0)	(▲ 0.0)	(1.0)	(0.0)	(▲ 0.0)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
Nominal GDP	▲ 0.0	▲ 0.6	0.3	1.6	4.3	4.4	4.4	2.8	1.9	1.7	1.6	1.3	3.7	2.0
GDP deflator	▲ 1.2	▲ 1.3	▲ 1.0	▲ 0.9	0.2	1.2	1.1	1.1	0.6	0.6	0.5	▲ 1.1	0.4	0.7
Consumer Price Index (excluding fresh food)	▲ 0.0	0.4	0.3	1.0	1.2	1.1	0.8	0.8	0.5	0.5	0.6	▲ 0.0	1.0	0.6
Unemployment Rate (%)	2.8	2.7	2.6	2.6	2.5	2.4	2.4	2.4	2.4	2.3	2.3	2.8	2.5	2.3
Exchange Rates (JY/US\$)	110	114	115	116	117	116	116	116	117	117	117	112	116	117
Import Price of Crude Oil (US\$/barrel)	73	80	85	90	84	81	79	78	79	76	74	76	84	77

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.