Monthly Report of Prospects for Japan's Economy

May 2022

Macro Economic Research Center

Economics Department

The Japan Research Institute, Limited

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This report is the revised English version of the April 2022 issue of the original Japanese version.

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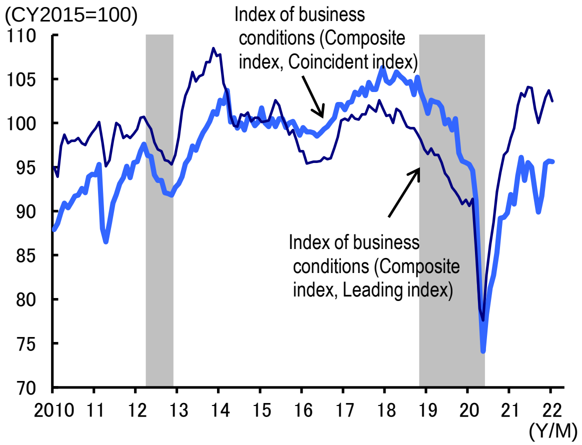
The General Situation – Economic recovery pauses

Figure 1-1 Economic Activity

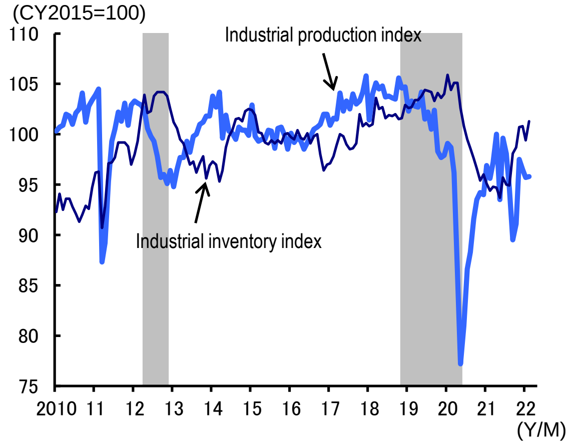
Both coincident and leading indices of business sentiment are sluggish.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

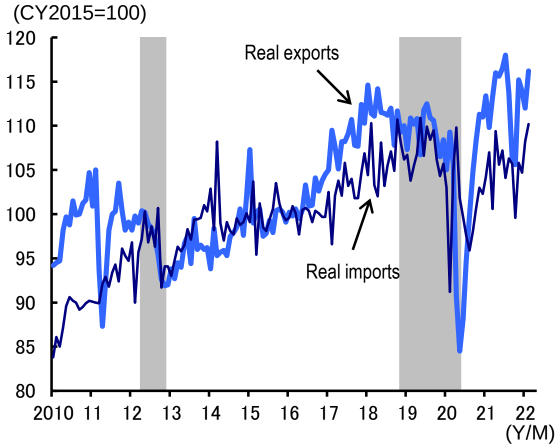
The Industrial Production Index is lackluster, with the materials sector, e.g., chemicals, the main laggard.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

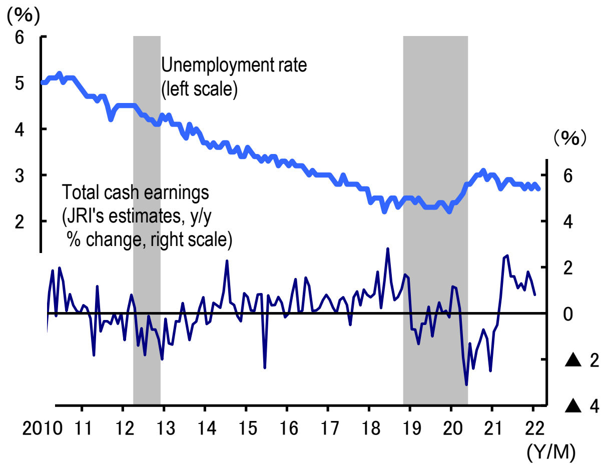
Exports to China and the U.S. are rising.Imports of general machinery and chemical products are increasing.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

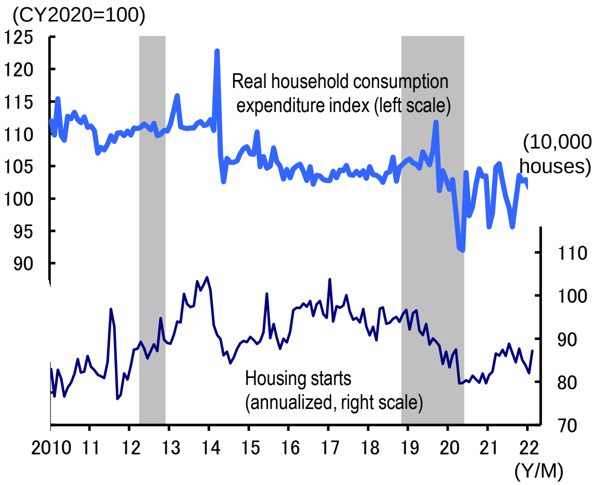
The unemployment rate is hovering in the high 2% range. Nominal wages are rising mainly due to overtime pay.



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

Figure 1-5 The Household Sector

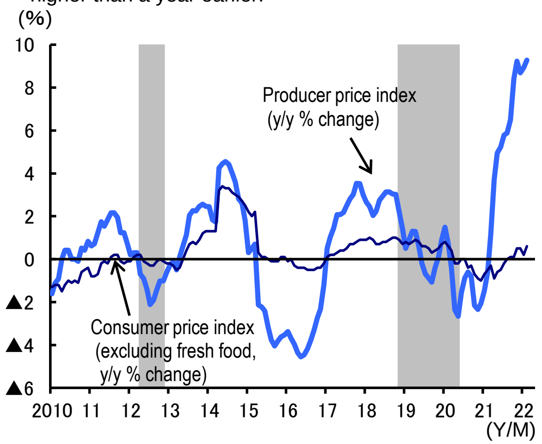
Real consumption is moving back and forth.Housing starts are low at 800,000 units.



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

Corporate goods prices, especially those of petroleum products, are climbing rapidly.Consumer prices are now higher than a year earlier.



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

＊The shaded area indicates the recession phase.

Improvement in business confidence among companies pauses, and personal consumption slumps

◆ DI for business conditions declines for the first time in seven quarters

According to the Bank of Japan's Tankan March survey, the DI for business conditions for large companies dropped to +11, the first decline in seven consecutive quarters. Looking at the breakdown, the manufacturing sector DI was +14, down three points from the previous survey. Business confidence worsened in the automotive and other sectors, which were forced to adjust production due to a sharp increase in the number of people infected with the Omicron strain.

Meanwhile, the non-manufacturing sector DI also declined for the first time in seven quarters, albeit slightly, to +9. Although business conditions in such sectors as information services held firm, those in consumer-related sectors such as accommodation/food services and personal services deteriorated due to a return of the “stay home” mood as the government authorized prefectures to impose targeted quasi-emergency restrictions on the sale of alcohol, opening hours, etc. (below, “quasi-emergency measures”).

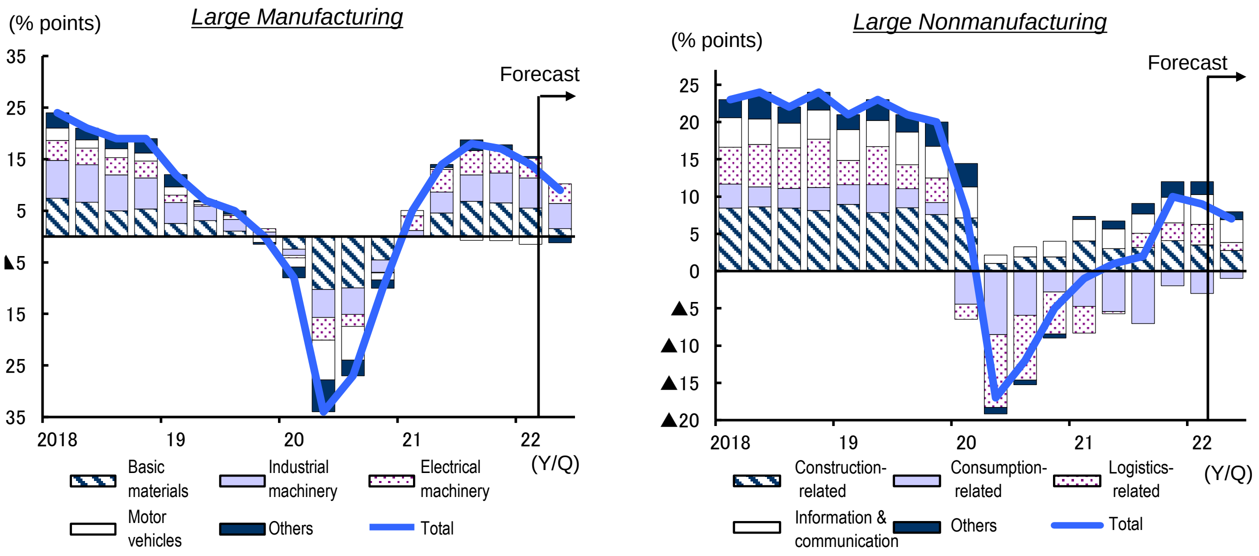
◆ Personal consumption falls again

In January, the Real Consumption Activity Index (adjusted for the travel balance) dipped 2.9%, the second consecutive month of month-on-month (MoM) decline. The breakdown shows a downward swing in services consumption due to spread of the Omicron variant..

◆ Production activity is about to pick up

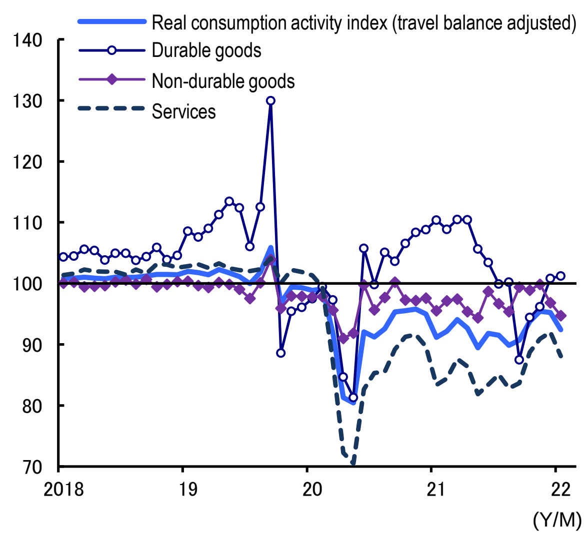
Although February’s Industrial Production Index remained weak at +0.1% MoM, production plans in March and April are expected to increase significantly by 3.6% MoM and 9.6% MoM, respectively. Although there remains a possibility that plans will be revised downward, the outlook for production is one of improvement. As foreign demand is firm, especially in advanced countries, where economic activity is normalizing following the COVID-19 pandemic, a clear recovery in exports is expected to be seen once production begins to pick up.

Figure 2-1 Contributions to the Business Conditions Diffusion Index by Industry
<diffusion index of "favorable" minus "unfavorable," and percentage point contribution to total DI points>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan March 2022 Survey".

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



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

Goods exports are rising, while inbound demand is close to zero

◆ Transportation machinery exports are rising

Goods exports increased in February for the first time in two months, up 2.4% from the previous month. By product category, exports of transportation machinery, which had been down due to the impact of factory shutdowns amid the spread of the Omicron strain, moved upwards.

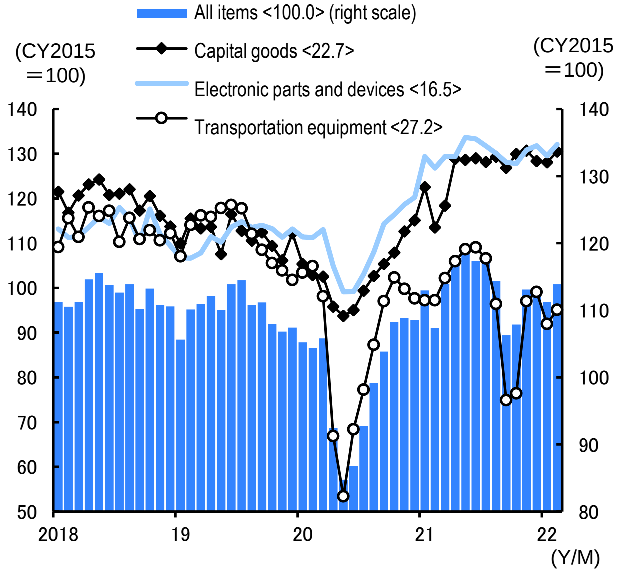
Looking ahead, exports are expected to continue to increase on the back of growing demand associated with the global economic recovery. According to the Bank of Japan's Tankan March survey, the DI for the overseas supply-demand balance for manufactured goods from large manufacturers, and for production machinery and electrical machinery, in particular, remained significantly positive (excess demand), indicating that overseas demand is projected to continue to improve. In transportation machinery, although some automakers temporarily adjusted production due to the March earthquake off the coast of Fukushima Prefecture, the underlying tone is expected to continue to pick up on the back of an easing supply constraints for semiconductors and other components.

◆ Inbound demand is almost zero

The number of foreign visitors to Japan in February was still down by the massive figure of 99.4% compared to 2019. However, the government has been gradually easing its anti-COVID waterfront protection measures, and in March resumed the acceptance of new foreign visitors, excluding tourists.

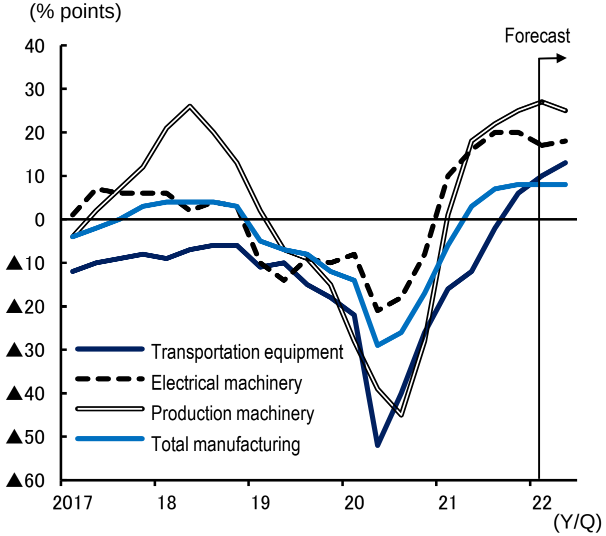
Global passenger traffic is picking up, and the International Civil Aviation Organization (ICAO) expects it to recover to 70% of pre-COVID levels by the end of 2022. With waterfront measures being relaxed worldwide, the assumption is that inbound demand will begin to recover in Japan in the second half of the year as restrictions on tourists entering the country are eased.

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



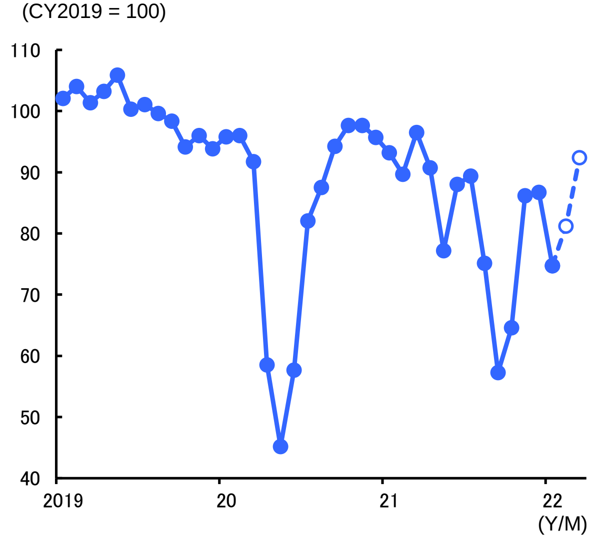
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2021.

Figure 3-2 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 March 2022 Tankan Survey.

Figure 3-3 Industrial Production Index for Transportation Equipment <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, trade and Industry.
Note:Figures are based on the production forecast index. The latest two figures are JRI estimates based on METI's method.

Corporate earnings are down, but capital investment picks up

◆ Corporate earnings drop in January-March quarter

According to the Financial Statements Statistics of Corporations, ordinary profit in October-December last year rose a significant 17.4% on an all-industry basis from the previous quarter. However, in the January-March quarter of this year, ordinary profit appears to have fallen again due to the renewed “stay home” mood as the Omicron strain proliferated, and also because some companies temporarily suspended plant operations as employees who were infected or were close-contacts of infected persons had to stay away and isolate at home.

Looking ahead, corporate earnings are likely to recover as restrictions on activities are eased in response to the lifting of quasi-emergency measures. That being said, rising resource prices triggered by Russia's invasion of Ukraine are expected to put downward pressure on earnings through higher costs. Although ordinary profit is expected to increase in FY2022, reflecting the recovery in economic activity following the COVID pandemic, it could be negative compared to the previous year if the WTI price level of over $130 takes hold.

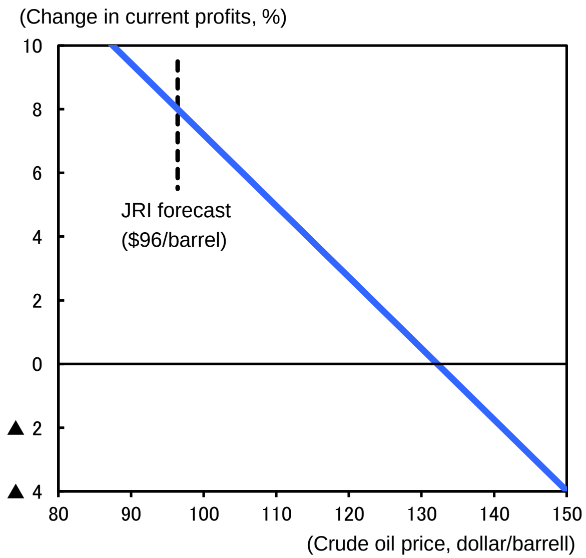
◆ Investment plans for FY2022 will be substantially higher

Capital investment in October-December last year increased for the first time in two quarters in both the manufacturing and non-manufacturing sectors, up 3.5% and 3.3%, respectively, from the previous quarter. Machinery orders and construction orders, leading indicators of capital investment, are also on the rise, as companies gradually resume investments that they had put on the back burner. According to the Bank of Japan’s Tankan March survey, large companies’ capital investment plans for FY2022 will increase substantially compared to pre-COVID levels. Companies are expected to maintain a positive investment stance, with the recovery trend in capital spending set to continue.

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

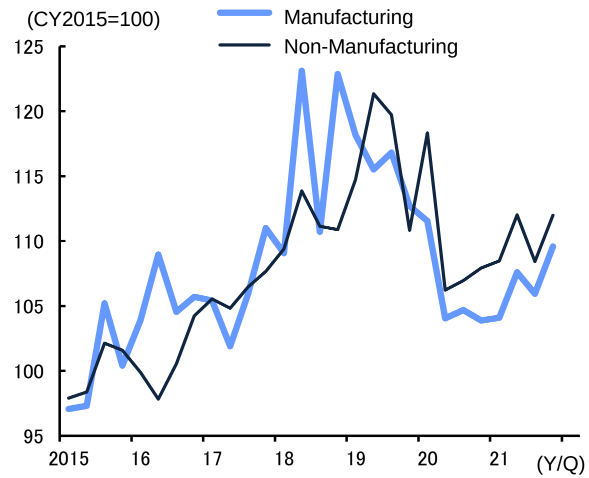
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 4-2 Current Profits Forecast by Oil Price Level (FY2022)



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

Figure 4-3 Business Fixed Investment of Japanese Corporations <all industries, 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.

The pace of recovery in employment and incomes is slowing

◆ Employment recovery is dragging its feet

The number of workers in February was unchanged from the previous month. Although the unemployment rate improved by 0.1 points from the previous month to 2.7%, the employment situation remained severe as the number of involuntarily unemployed persons increased for the fourth consecutive month and the number of furloughed workers climbed again as the period of application of quasi-emergency measures was extended. In the accommodation/food services sector, which was forced to operate with shorter hours, the share of furloughed employees in the total workforce rose to 8.1%.

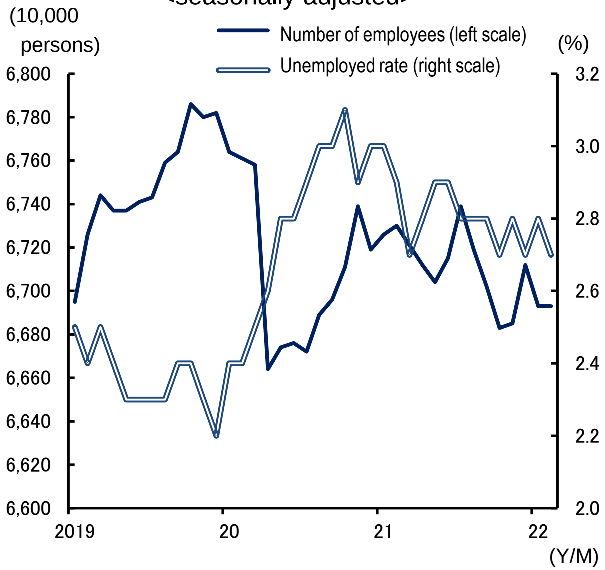
Looking ahead, the employment situation is expected to improve as activity restrictions ease. However, the pace of improvement in employment is likely to remain moderate due to high levels of uncertainty concerning the infection situation going forward. For example, the pace of decline in the number of new infections has slowed recently.

◆ A decline in non-regular employment boosts average wages

Total cash payrolls in February increased 1.0% year on year (YoY), and although the positive trend continues, mainly due to the slow recovery in non-regular, i.e., part-time, employment, for which wage levels are low, the environment surrounding wages remains harsh. Although the rates of wage increases demanded during in this year's shunto spring wage offensive were generally higher than last year, it appears that only a small number of companies raised wages by the 3%+ level that the government had requested of the business community.

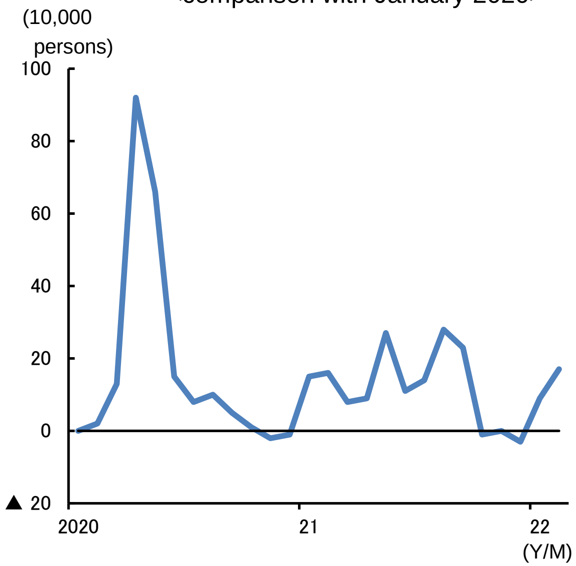
Looking ahead, as consumption activity gradually begins to normalize, non-regular employment is expected to increase, exerting downward pressure on average wages.

Figure 5-1 Number of Employees and Number of Unemployment Rate
<seasonally adjusted>



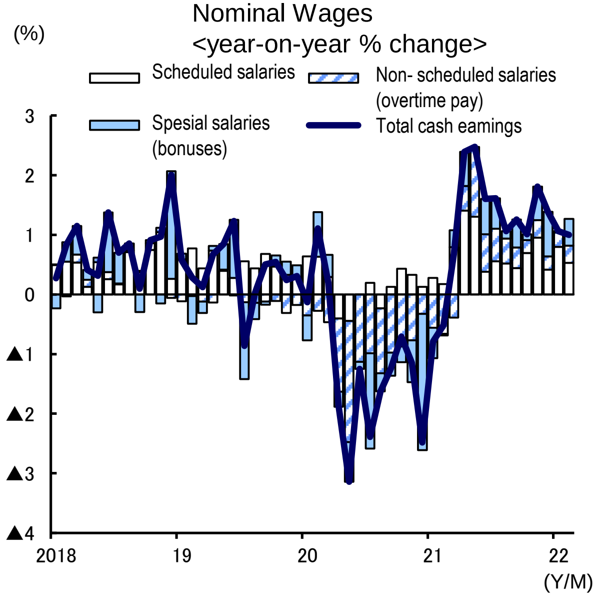
Source: The Japan Research Institute, Ltd. based on data of The Minustry of Internal Affairs and Communications.

Figure 5-2 Number of Lodging and Restaurant Businesses Closed
<comparison with January 2020>



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

Figure 5-3 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.

Personal consumption picks up, but high prices due to the invasion of Ukraine pose a risk

◆ Personal consumption is showing signs of recovery

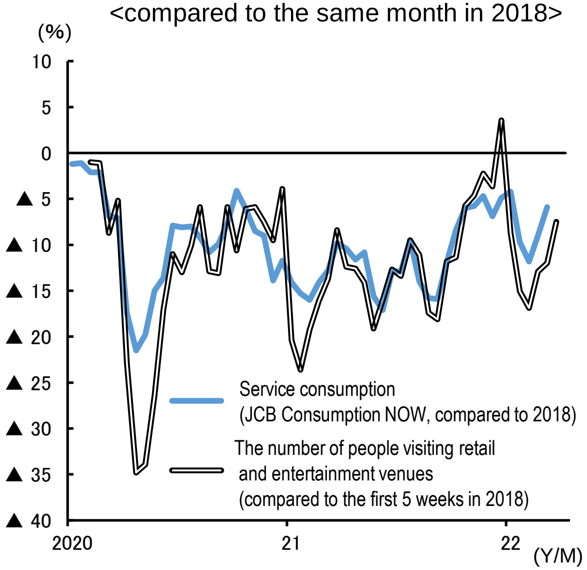
Consumer spending is down due to the spread of COVID since the beginning of the year and the accompanying application of quasi-emergency measures. There has been a renewed drop in foot traffic to retail and entertainment establishments, and moves to refrain from service consumption, including dining out and travel. On the supply side, cuts in production of automobiles and other goods as well as store closures due to employees who were infected or were close-contacts of infected persons isolating at home have put downward pressure on consumption. However, since late February, both business activity and services consumption have picked up slightly amid a decline in the number of new infections.

◆ The normalization of economic activity has provided clearer prospects of a recovery in consumption

Although the outlook for the COVID infection situation is highly uncertain, the assumption is that the number of new infections will settle down to a controllable level during the April-June quarter, and a re-imposition of quasi-emergency measures will be avoided. If this proves to be the case, the recovery in personal consumption is expected to become clearer again.

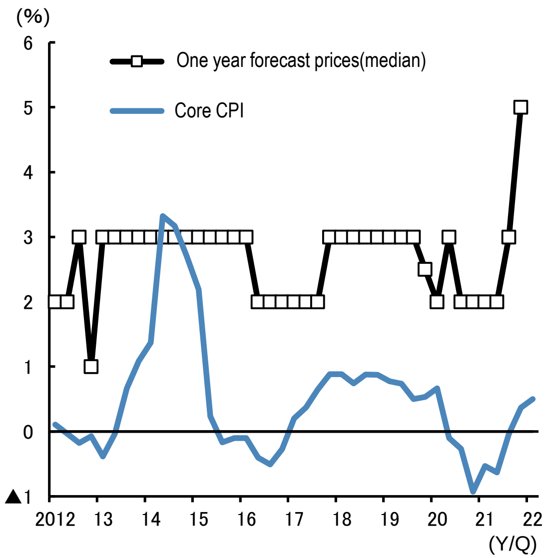
However, attention needs to be paid to the negative impact on consumer spending of rising resource prices and market turmoil in the wake of Russia's invasion of Ukraine. It is estimated that households of two or more people will bear an increased burden of about 5,300 yen per month from higher consumer prices, mainly for energy, and that the decline in stock prices since the beginning of the year will depress personal consumption by 0.2% through the asset effect. If the invasion of Ukraine becomes a quagmire, leading to another surge in resource prices and a further decline in stock prices, the scenario that consumption will begin to recover from the COVID pandemic as economic activity normalizes could be disrupted.

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



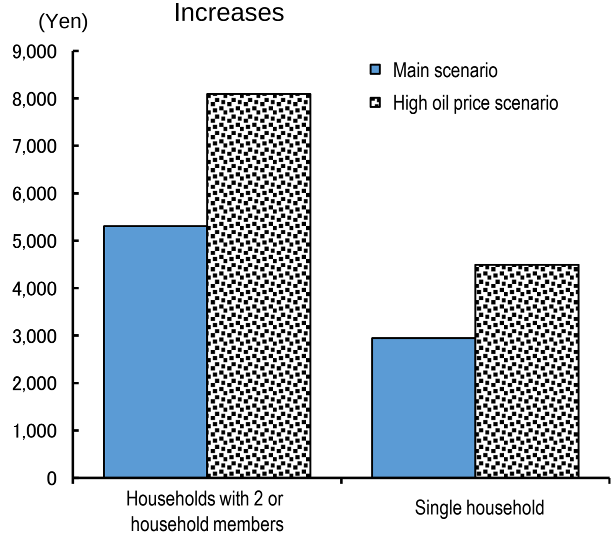
Source: The Japan Research Institute, Ltd. based on data of JCB Consumption Now, Google.

Figure 6-2 Consumer Prices and Forecast Prices



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

Figure 6-3 Monthly Increase in Burden per Household Associated with Price Increases



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

Note: Main scenario is $96 on WTI basis, high oil price scenario is $150.

Topic: New travel styles have taken root amid the COVID pandemic

◆ The COVID pandemic has led to new travel demand

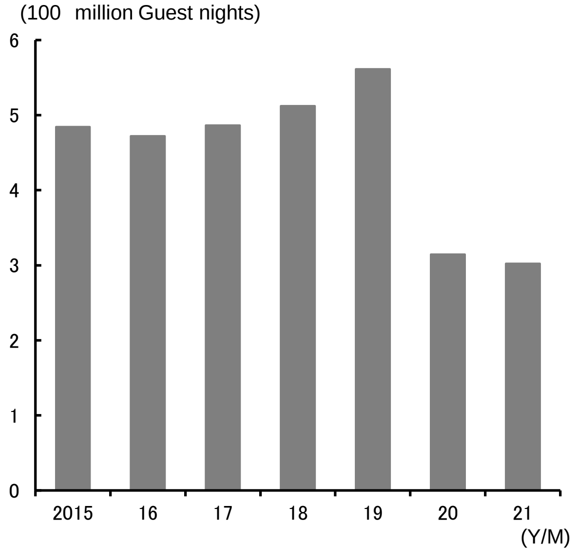
Consumers have been refraining from traveling since the spread of COVID began. Looking at the number of total domestic overnight stays, there was a sharp drop in 2020, and the low levels continue in 2021 (-46.1% compared to 2019, pre-COVID). However, the spread of COVID has also triggered new travel demand. Comparing travel destinations by place of residence before and after COVID erupted, it is possible to spot two trends: 1) travel that avoids human density (decreased travel from rural and tourist areas to large cities) and 2) travel that avoids long journeys (increased travel within the same area as the place of residence).

◆ A low-risk travel style has become popular

This style of travel has proliferated throughout the country in the forms of "microtourism," meaning trips to nearby places, and "undertourism," meaning travel to off-the-beaten-path spots. Some municipalities have doubled their annual revenues to twice the pre-COVID level by attracting travelers from nearby areas to their single-unit lodging facilities, while others have attracted tourists by putting out information about hidden tourist attractions.

With no end to COVID in sight, this new travel demand may take root as people seek to reduce the risks of infection associated with crowds and lengthy journeys. However, since such demand means low per-person travel expenditures, the challenge for the future will be to increase the per-trip spend by offering new activities while still curtailing the risk of infection.

Figure 7-1 The Number of Total Domestic Overnight Stays



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

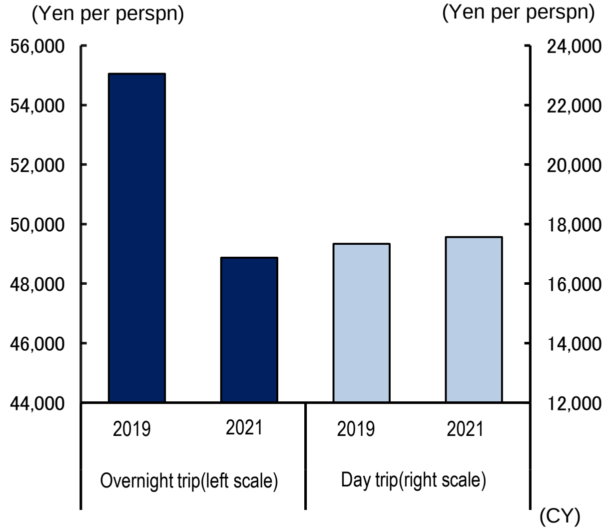
Figure 7-2 Change in Travel Destinations by Place of Residence Before and After The COVID

place of residence ＼travel destinations	Large cities	Rural	Tourist areas
Large cities	68%→74%	20%→17%	12%→9%
Rural	60%→50%	34%→47%	6%→4%
Tourist areas	33%→18%	7%→5%	60%→78%

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

Note1: Red is a transfer from rural areas and tourist areas to large cities. Blue is the movement of the same area as the place of residence.

Figure 7-3 Travel Expenditures for Domestic Trips <per person>



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

Prospects for Japan's Economy - Projected Real GDP Change; 2.4% for FY2021 and 3.0% for FY2022

◆ High levels of positive growth will appear from the April-June quarter

In the January-March quarter, services consumption was down due to a renewed "stay home" mood following the outbreak of the Omicron strain and the application of quasi-emergency measures. Furthermore, real GDP growth appears to have slowed to an annualized rate of 0-1% as the sharp increase in the number of infected persons and close-contacts suppressed output in the manufacturing sector.

In April-June, services consumption is expected to increase again as economic activities begin to normalize, thanks in part to the lifting of quasi-emergency measures. A recovery in manufacturing production activity, reflecting the easing of supply constraints, is also expected to boost exports and capital investment, resulting in higher growth.

However, attention needs to be paid to the impact of Russia's invasion of Ukraine on the Japanese economy. At this point, we maintain the view that the recovery will become clearer as economic activity normalizes following the COVID pandemic, but the recovery scenario could be disrupted if the situation continues to deteriorate, causing resource prices to rise even higher or remain high, or if the European economy sees a significant downturn.

◆ Growth rate will be +3.0% in FY2022

Growth rates for FY2021 and FY2022 will have been (will be) +2.4% and +3.0%, respectively, meaning that there will have been two consecutive years of higher positive growth on the back of a recovery in economic activity in the aftermath of the COVID pandemic. The pace of growth will slow significantly to +1.3% in FY2023, reflecting the normalization of economic activity.

◆ Growth rate will be +3.0% in FY2022

The core CPI rose for the sixth consecutive month in February, with the YoY rate of change standing at +0.6%. Although mobile communications charges continued to fall sharply, higher energy prices pushed up the overall figure.
Although inflation fears have been growing recently against the backdrop of soaring resource prices and a weakening yen, companies are cautious about passing on prices to consumers, and the likelihood of inflation accelerating significantly across a wide range of goods and services is low. However, the core CPI is expected to rise to 2% on the back of higher energy and food prices and a smaller decline in mobile communications charges.

◆ Prices of goods rise for sixth straight months

The core CPI rose for the sixth consecutive month in February, with the YoY rate of change standing at +0.6%. Although mobile communications charges continued to fall sharply, higher energy prices pushed up the overall figure.

Although inflation fears have been growing recently against the backdrop of soaring resource prices and a weakening yen, companies are cautious about passing on prices to consumers, and the likelihood of inflation accelerating significantly across a wide range of goods and services is low. However, the core CPI is expected to rise to 2% on the back of higher energy and food prices and a smaller decline in mobile communications charges.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of April 9, 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			
	(Actual)	(Projection)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	▲ 2.8	4.6	0.5	6.7	3.2	1.4	1.1	1.1	1.1	0.9	0.9	2.4	3.0	1.3
Private Consumption Expenditure	▲ 3.8	10.0	▲ 1.2	7.3	3.0	1.2	1.2	1.0	1.0	0.8	0.8	2.6	3.3	1.2
Housing Investment	▲ 6.3	▲ 3.8	2.0	3.8	2.9	1.5	0.0	0.5	0.2	0.0	0.0	▲ 1.1	1.2	0.5
Business Fixed Investment	▲ 9.3	1.4	5.3	6.7	4.8	4.0	2.8	2.6	2.6	2.4	2.4	1.4	3.8	2.9
Private Inventories (percentage points contribution)	(0.4)	(▲ 0.5)	(0.1)	(0.7)	(0.4)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(0.2)	(0.0)
Government Consumption Expenditure	4.5	▲ 1.4	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	▲ 11.6	▲ 14.4	2.5	7.8	4.8	▲ 2.1	▲ 1.5	0.2	0.6	0.8	0.4	▲ 7.6	0.5	0.0
Net Exports (percentage points contribution)	(0.4)	(0.9)	(▲ 0.3)	(▲ 0.3)	(▲ 0.1)	(▲ 0.1)	(▲ 0.1)	(0.0)	(0.0)	(▲ 0.0)	(▲ 0.0)	(1.0)	(0.0)	(▲ 0.0)
Exports of Goods and Services	▲ 1.2	3.8	3.2	4.4	3.6	3.2	3.2	3.0	3.0	2.6	2.6	12.6	3.4	3.0
Imports of Goods and Services	▲ 3.8	▲ 1.5	4.5	5.2	3.6	3.4	3.2	2.7	2.7	2.6	2.6	6.3	3.0	2.9
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 1.2)	(3.8)	(3.2)	(4.4)	(3.6)	(3.2)	(3.2)	(3.0)	(3.0)	(2.6)	(2.6)	(12.6)	(3.4)	(3.0)
(Ref.) Public Demand (percentage points contribution)	(▲ 3.8)	(▲ 1.5)	(4.5)	(5.2)	(3.6)	(3.4)	(3.2)	(2.7)	(2.7)	(2.6)	(2.6)	(6.3)	(3.0)	(2.9)

(% changes from the same quarter of the previous year) (% changes from the previous fiscal year)

Nominal GDP	▲ 0.1	▲ 0.9	▲ 0.4	0.6	3.2	3.4	3.9	2.7	1.8	1.6	1.5	1.1	2.8	1.9
GDP deflator	▲ 1.2	▲ 1.3	▲ 1.3	▲ 1.6	▲ 0.5	0.4	0.6	1.0	0.6	0.5	0.5	▲ 1.2	▲ 0.3	0.6
Consumer Price Index (excluding fresh food)	▲ 0.0	0.4	0.4	1.6	1.8	1.8	1.4	1.0	0.5	0.2	0.3	0.0	1.7	0.5
Unemployment Rate (%)	2.8	2.7	2.7	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$)	110	114	116	122	123	124	124	124	123	122	122	112	123	123
Import Price of Crude Oil (US$/barrel)	73	80	87	111	106	100	93	90	86	84	83	77	102	86

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.