

Monthly Report of Prospects for Japan's Economy

August 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 July 2022 issue of the original Japanese version.

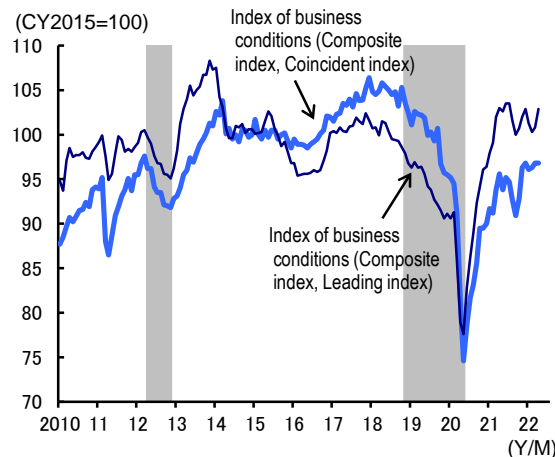
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The General Situation – Personal consumption is picking up, production and exports are down

Figure 1-1 Economic Activity

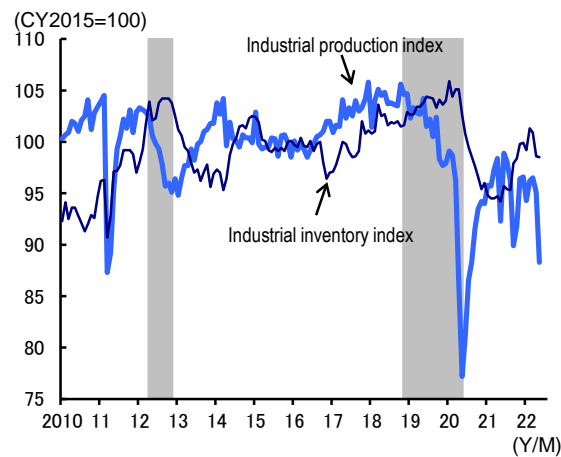
Regarding indices of business sentiment, coincident indices are bouncing back, while leading indices are more or less flat.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

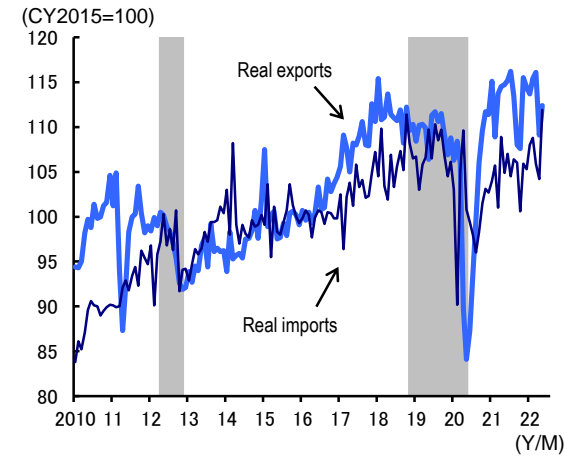
Industrial production has fallen sharply due to the supply chain paralysis resulting from China's lockdowns.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

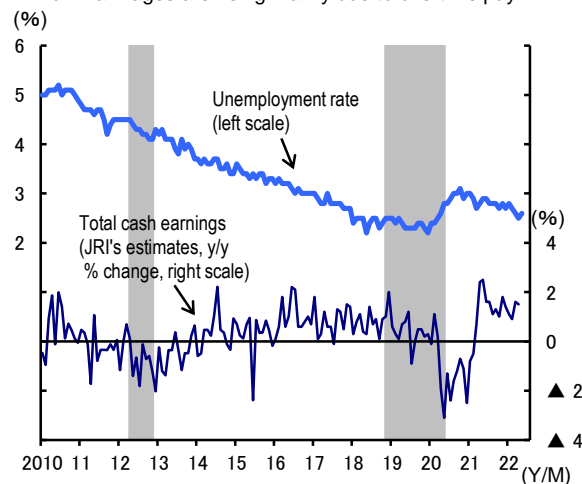
Exports to China are down. Imports have picked up after a temporary downturn.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

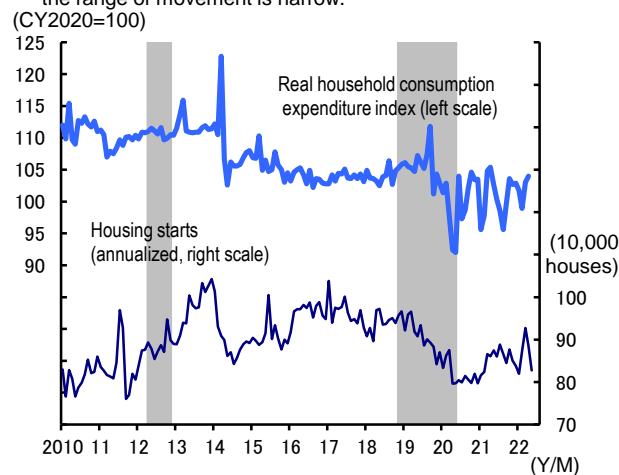
The unemployment rate is bobbing up and down. Nominal wages are rising mainly due to overtime pay.



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

Figure 1-5 The Household Sector

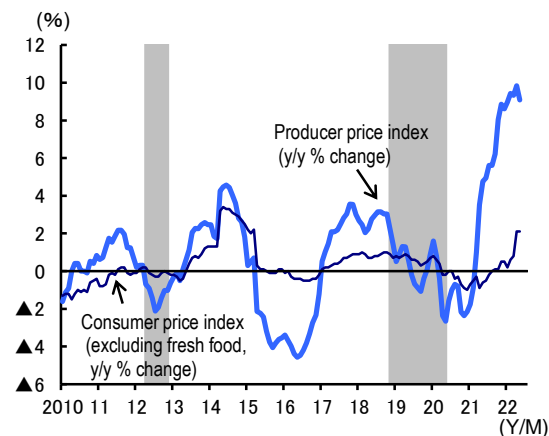
Real consumption is picking up due to the easing of activity restrictions. Housing starts are fluctuating, but the range of movement is narrow.



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 price inflation is still topping 9%. Consumer prices were over 2% higher than a year earlier for the second consecutive month.



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Bank of Japan.
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* The shaded area indicates the recession phase.

Business confidence is polarized, with a marked difference between manufacturing and non-manufacturing sectors

◆ Business confidence has deteriorated in the manufacturing sector, but improved in the non-manufacturing sector

In the Bank of Japan's Tankan June survey, the DI for business conditions for large manufacturing companies slipped to +9, worsening for the second straight quarter. Compounding the issue of higher raw material costs due to rising resource prices, supply chain snarl-ups stemming from the lockdowns in China exerted additional downward pressure on business confidence.

Meanwhile, the DI for large non-manufacturing companies improved for the first time in two quarters to +13. Looking at the breakdown, the DI for firms providing personal services, which had been in negative territory due to COVID-19, turned positive, while that for companies in the accommodation/food services business remained negative, though to a lesser degree than before.

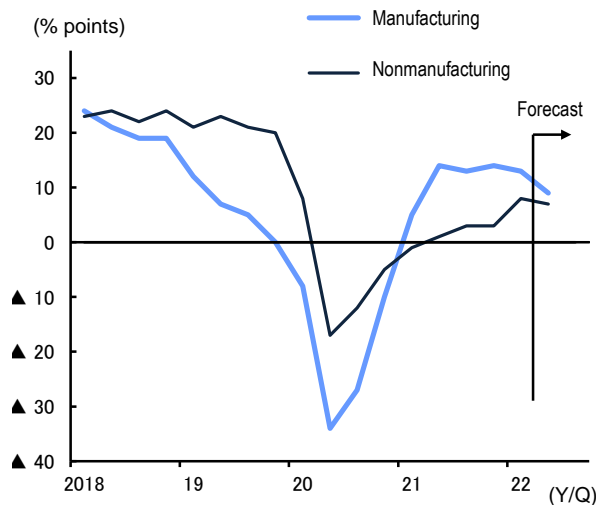
◆ Exports have picked up

Real exports increased in May for the first time in two months. By region, shipments to China remained tepid because of the lockdowns there, but those to the U.S. and Europe held firm.

◆ Production has plummeted due to China's lockdowns

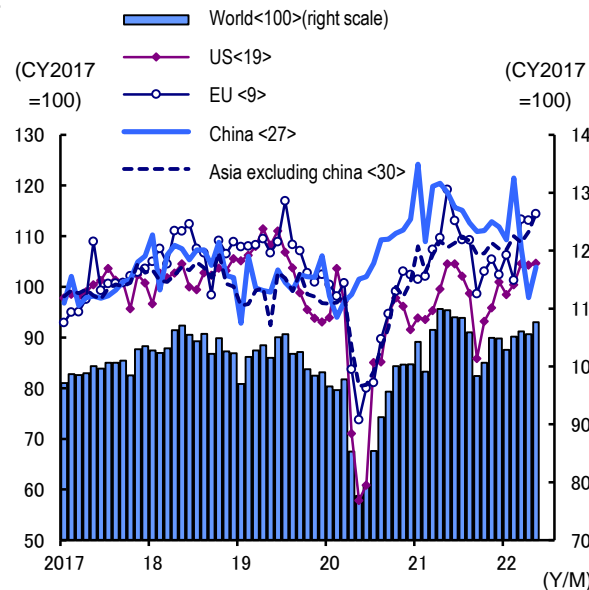
In May, the Industrial Production Index dipped sharply, down 7.2% from the previous month. Companies were faced with parts shortages due to the Chinese lockdowns, and many factories suspended operations in the middle of the Golden Week string of public holidays. These factors seem to have taken their toll on the index. Near-future production plans indicate significant increases in output in June (+12.0% month-on-month (MoM)) and July (+2.5% MoM). However, there is a strong sense of uncertainty surrounding the impact of the supply chain disruptions, and there is a risk that plans will be revised downward.

Figure 2-1 DI for Business Conditions for Large Companies <diffusion index of "favorable" minus "unfavorable", and percentage point contribution to total DI points>



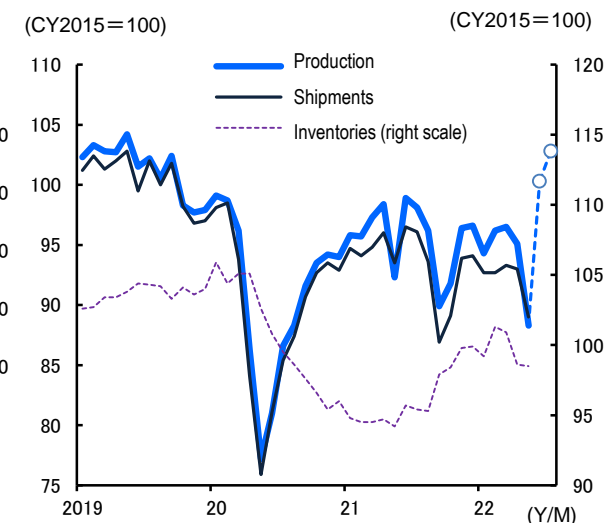
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan June 2022 Survey".

Figure 2-2 Real Export <seasonally adjusted>



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

Figure 2-3 Industrial Production Index <seasonally adjusted>



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

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

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Goods exports are rising, and inbound demand is set for a gradual recovery

◆ Exports of capital goods and electronic components have increased

Goods exports climbed in May for the first time in two months. By product category, while exports of transportation machinery dropped as a result of production cutbacks due to shortages of components supplied from China, exports of capital goods and electronic components/devices picked up.

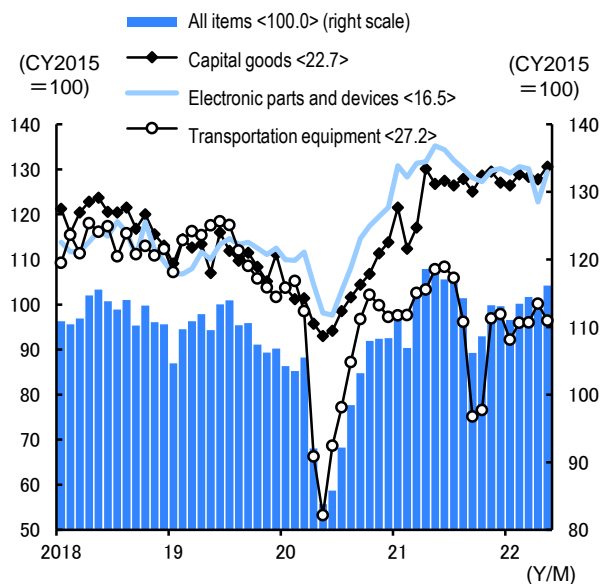
Looking ahead, exports of capital goods and electronic components are expected to continue heading upward on the back of the global economic recovery. Transportation machinery exports are also predicted to increase as the dearth of parts is resolved, thanks to the Shanghai lockdown having been lifted and production and logistics beginning to normalize. However, the zero-COVID policy is still in place in China, and there is a risk of another downturn in exports if fresh lockdowns are imposed.

◆ The government has eased waterfront measures

The number of foreign visitors to Japan in May was 147,000, exceeding the 100,000 mark for the second consecutive month, but was still down more than 90% from the pre-COVID level. Although the government raised the maximum number of visitors to the country to 20,000 per day in June and resumed acceptance of foreign tourists (though for package tours only), the relaxation of waterfront measures is being implemented in phases, so a rapid recovery in the number of tourists is unlikely.

At the global level, passenger traffic is bouncing back, and the International Civil Aviation Organization (ICAO) expects it to rev up to around 90% of pre-COVID levels by the end of 2022. Here in Japan, too, a recovery of inbound demand is expected to become more apparent as progress is made in terms of readiness to accept inbound visitors.

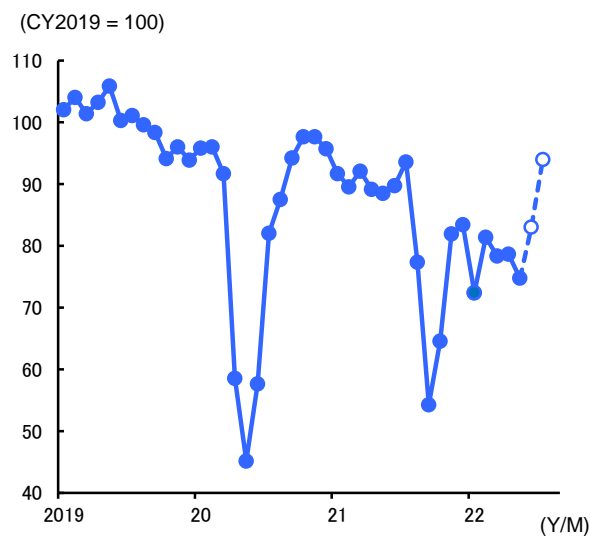
Figure 3-1 Real Exports by Item
<seasonally adjusted>



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.

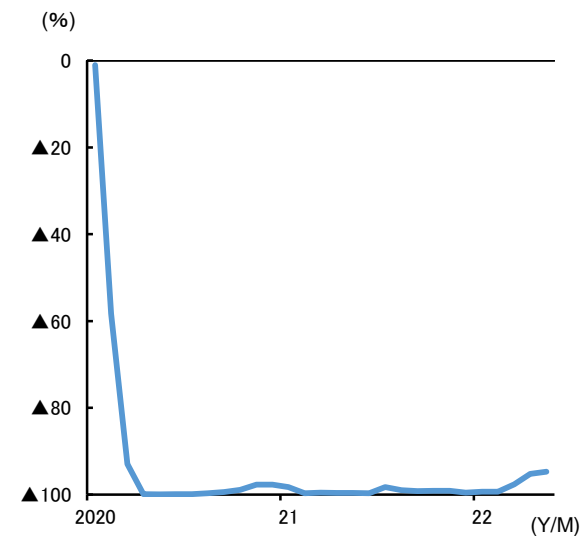
Figure 3-2 Industrial Production Index for Transportation Equipment
<seasonally adjusted>



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.

Figure 3-3 The Number of Foreign Visitors to Japan
<compared to the same month in 2019>



Source: The Japan Research Institute, Ltd. based on data of the Japanese National Tourism Organization.

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High corporate earnings are supporting capital investment

◆ Corporate earnings are increasing

According to the Financial Statements Statistics of Corporations, ordinary profit for all industries in January-March rose by 0.2% from the previous quarter, a small increase, but marking two straight quarters in positive territory. April-June may have been the third consecutive quarter of profit growth, as revenues from accommodation/food services and lifestyle-related services picked up on the back of a recovery in services consumption following the relaxation of activity restrictions.

Looking ahead, the pace of profit growth will be lower than in the previous fiscal year due to higher costs associated with rising resource prices, but companies will absorb the cost increases to a certain extent through improved efficiency. Normalization of economic activity will also give a boost to earnings, especially in the non-manufacturing sector, so corporate profits are expected to remain at high levels.

◆ Capital investment is seeing a moderate recovery

According to the Financial Statements Statistics of Corporations, capital investment in January-March increased for the second quarter in a row. Large companies' capital investment plans for FY2022 are also substantially higher than pre-COVID levels as companies maintain a positive investment stance. And going forward, capital investment is expected to continue to recover, supported by high corporate earnings. However, there is a strong sense of uncertainty surrounding future developments with respect to Russia's invasion of Ukraine and China's action on COVID, and attention needs to be paid to the risk of caution on the part of more and more investors.

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

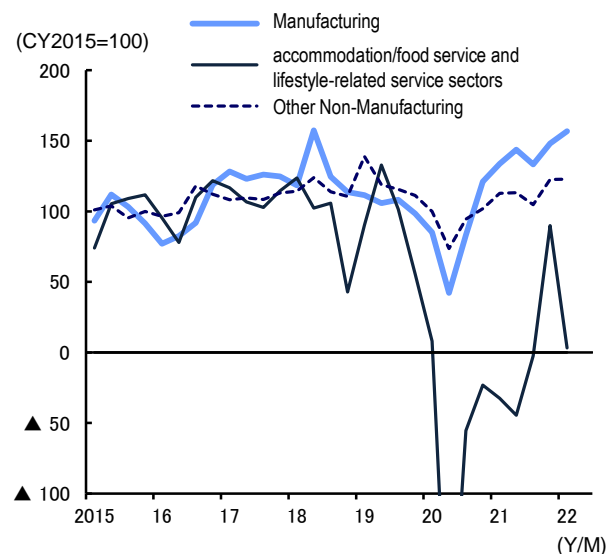


Figure 4-2 Current Profit and Ratio of Current profits to Assets <seasonally adjusted>

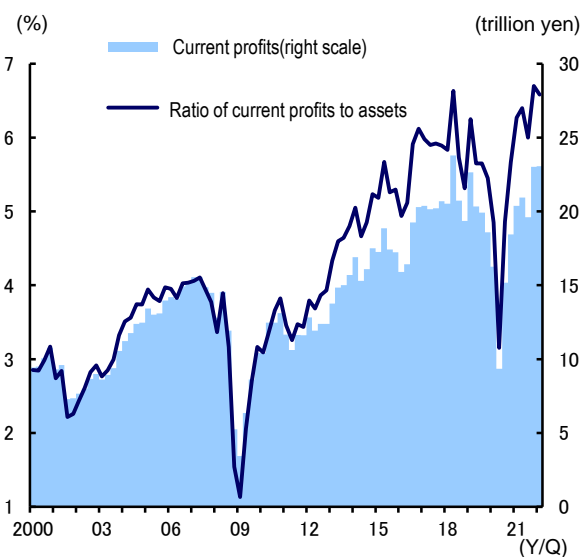
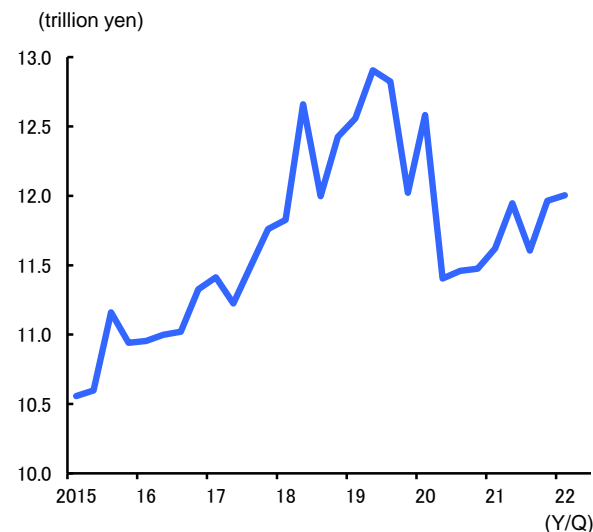


Figure 4-3 Business Fixed Investment of Japanese Corporations <all industries, seasonally adjusted>



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

Note: All industries except for financial services and insurance.

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High prices are putting downward pressure on real incomes

◆ The improvement in the employment situation has paused

In May, the number of workers decreased by 140,000 from the previous month. Furthermore, the improvement in employment paused as the unemployment rate rose to 2.6%, the first uptick in four months. However, the employment environment also features some positives. The number of effective job openings continues to increase and voluntary unemployment is on the rise, possibly indicating that more workers are feeling good about the labor market and looking to make career changes.

Looking ahead, the employment situation is unlikely to improve rapidly due to lingering uncertainty over the COVID infection situation, but is still expected to continue getting better on the back of the recovery in services consumption and inbound demand.

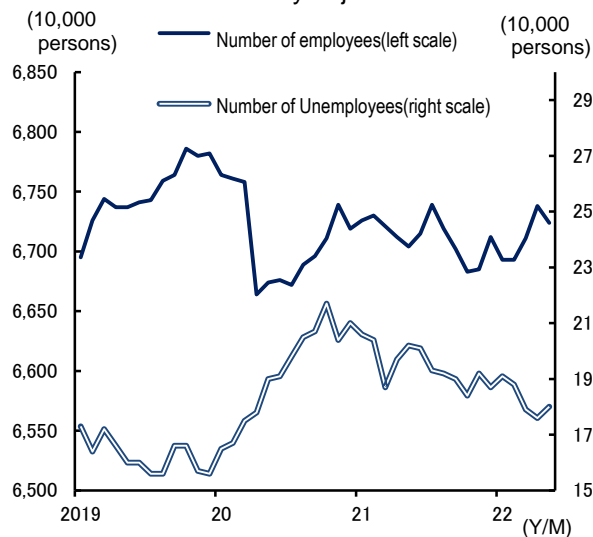
◆ Real wage growth rate has turned negative

Total cash payrolls in April increased 1.5% year on year (YoY), staying in positive

territory. The rise is mainly due to the slow recovery in non-regular, i.e., part-time, employment, for which wage levels are low, so wage growth is actually weak. In addition, real wages declined by 1.4% YoY amid rising prices. Furthermore, while this summer's pay bonuses are thought to have recovered almost to pre-COVID levels at large companies, small and medium-sized enterprises are still being affected by the pandemic, so overall bonus growth was probably minor.

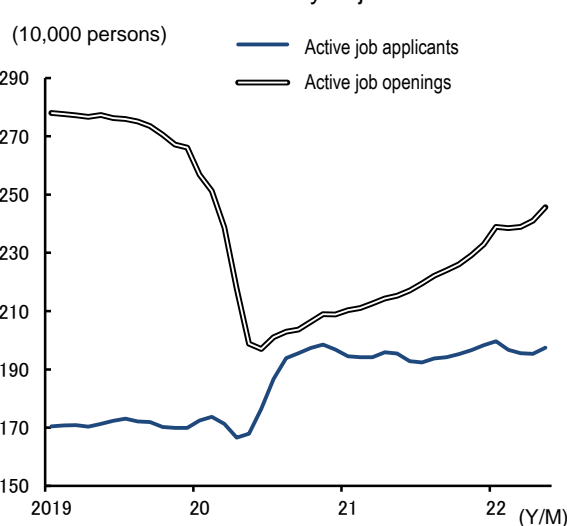
Looking ahead, with consumption beginning to normalize, non-regular employment with low wage levels is expected to increase again, piling downward pressure on average wages, and because inflation will continue for the time being, real wages look set to keep falling.

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



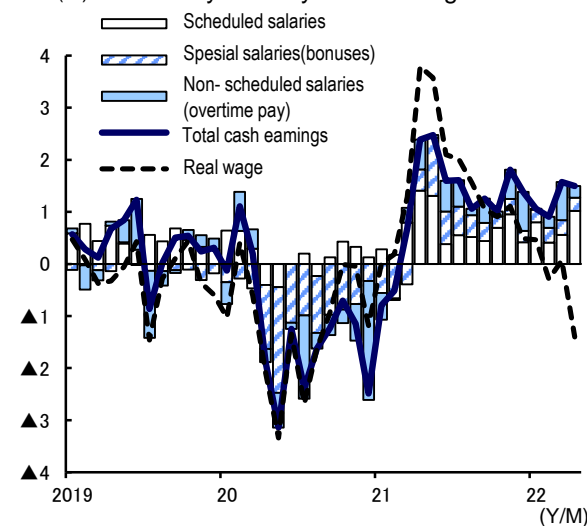
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Active Job Openings and Active Job Applicants
<seasonally adjusted>



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

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 is picking up, but the possibility of supply chain disruptions becoming

◆ Personal consumption is recovering

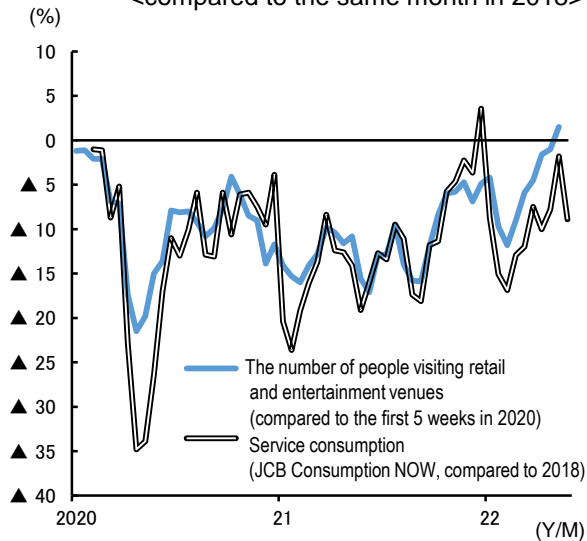
Regarding consumer spending, services consumption is rebounding as more people get out and about due to the easing of restrictions on activities. Some prefectures have introduced “prefectural residents discount” programs, which provide subsidies for travel within one’s own prefecture, and “regional block discount” programs, which extend the subsidies to travel to neighboring prefectures, and travel demand during Golden Week (consecutive public holidays in early May) proved to be a key driver for a revving up of consumption among young people. Subsequently, services consumption continued to rebound, even recovering in the first half of June to a level higher than at the end of last year.

◆ The normalization of economic activity is boosting consumption

The government plans to expand the local travel discount programs to cover nationwide travel in July, and services consumption is expected to continue to recover thanks to the demand-stimulating effect of the discounts.

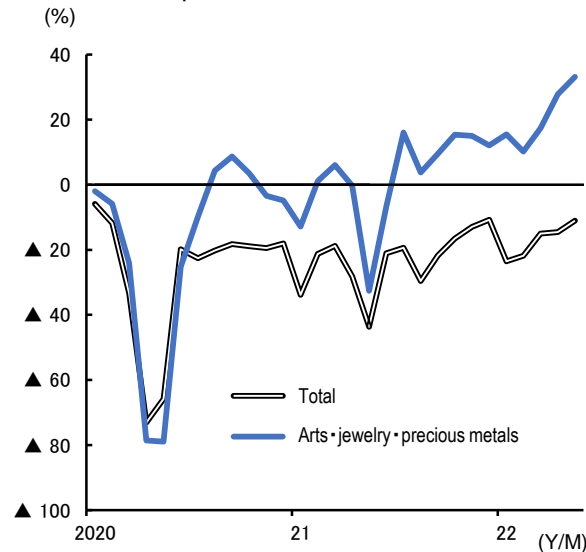
Meanwhile, although the view that prices are going to keep rising has spurred some people to rush to department stores to purchase luxury items before their prices go up, automobile sales are still flagging. The supply chain issues triggered by Chinese lockdowns are continuing to take their toll. Customers have to wait a long time to take delivery of vehicles they order, and this is hammering sales. Even though Shanghai’s lockdown has already been lifted, caution is needed regarding the risk that lockdowns will be imposed again in the future, including in other areas, prolonging the adverse effects on production and sales.

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



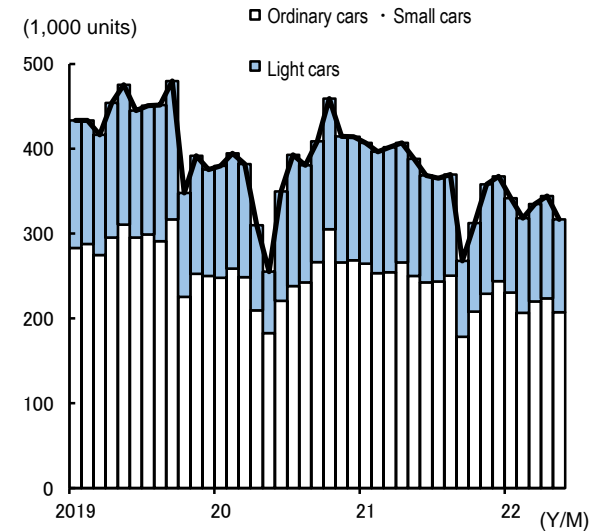
Source: The Japan Research Institute, Ltd. based on data of JCB Consumption Now, Google.

Figure 6-2 Department Store Sales
<compared to the same month in 2018>



Source: The Japan Research Institute, Ltd. based on data of Japan Department Stores Association.

Figure 6-3 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.

Topic: The weak yen is straining the profitability of the materials sector, and there are concerns about capital investment

◆ The yen's depreciation is weighing on the materials sector

The yen has been becoming increasingly frail in the foreign exchange market, with its value falling about 15% in the last three months. This slide in the yen is putting pressure on earnings in the materials sector against a backdrop shaped by the following two factors:

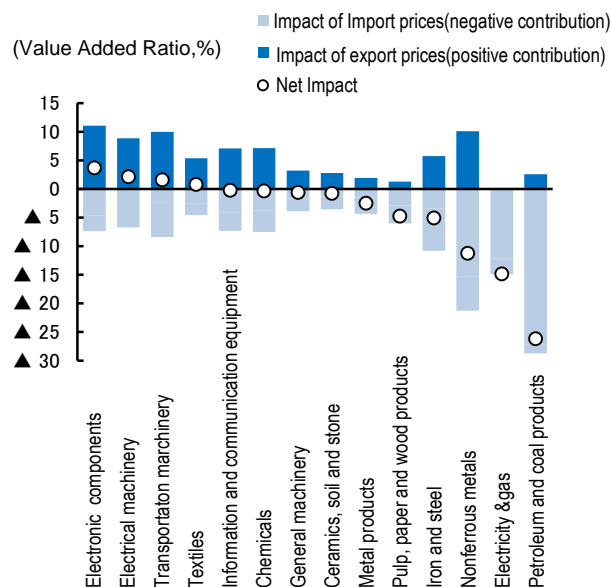
First, import prices are going up. A lackluster yen impacts bottom lines by pushing up both import and export prices in yen terms. According to estimates, in industries that process parts and materials into products, such as the electronic components and transportation machinery sectors, the positive effect (on earnings) of higher export prices tends to outweigh the negative effect of higher import prices. In the materials sector, however, the negative effect is greater. In industries such as petroleum/coal products and nonferrous metals, revenue-reducing pressure is 10-20% of the value added.

Second, the effect of boosting earnings from overseas is small. Although a weaker yen lifts yen-denominated earnings from overseas investments, in the form of higher dividends from overseas subsidiaries, for example, foreign direct investment by firms in the materials sector, with the exception of chemicals, is minimal.

◆ There are concerns about curtailment of capital investment

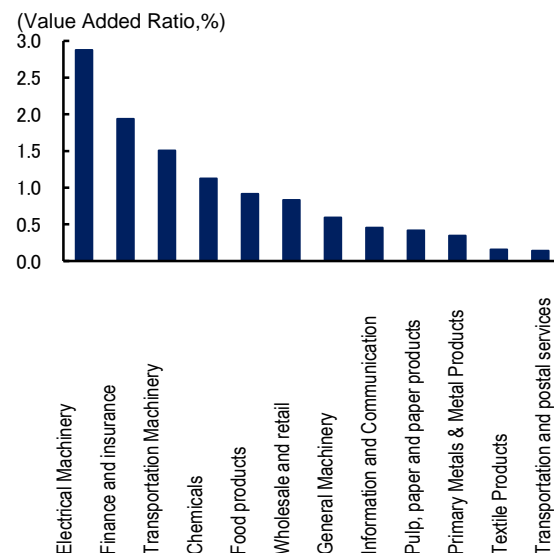
Earnings forecasts for the materials sector have revised downward across the board, as all the firms are being impacted by high resource prices. While processing companies are generally sticking with their forecasts for higher profits, materials firms have adjusted their forecasts, projecting lower profits. In petroleum/coal products and nonferrous metals, the rate of profit decline is predicted to be 30%. Since the materials sector is planning hefty capital investments, including ones related to decarbonization, the impact of these downward revenue pressures on future investment plans will need to be closely monitored.

Figure 7-1 Impact of 15% Yen Depreciation on Value Added



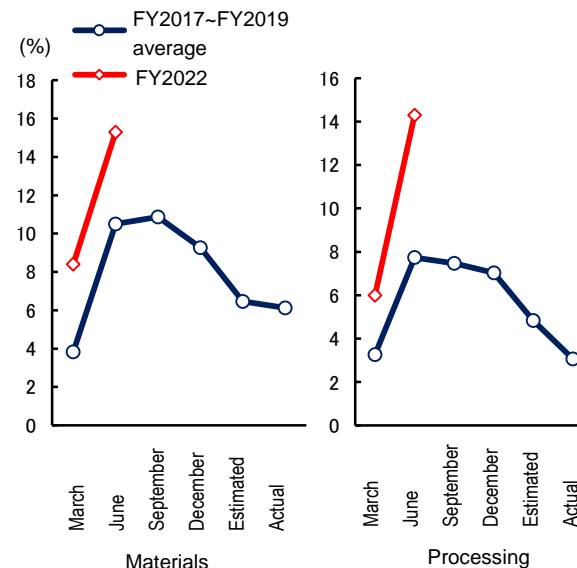
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications, The Bank of

Figure 7-2 15% Yen Depreciation Boosts Direct Investment Income



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

Figure 7-3 Capital Investment Plan <year-on-year % change>



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

Prospects for Japan's Economy - Projected Real GDP Change; 2.6% for FY2022 and 1.4% for FY2023

◆ The recovery of services consumption will drive the economy

The economy is expected to show marked improvement, driven by services consumption, based on the assumption that the COVID situation will remain relatively calm.

In the household sector, although higher energy and food prices due to the weaker yen and higher resource prices are putting downward pressure on household purchasing power, many households have significantly increased their savings as a result of staying home during the COVID pandemic, making them more resilient to rising prices. Personal consumption is therefore expected to continue to recover with the normalization of economic activity as the pandemic recedes.

The corporate sector will be weighed down by higher costs due to rising resource prices, but companies will absorb the cost increases to a certain extent through improved efficiency. And the recovery trend in capital investment is expected to remain largely intact against the backdrop of high corporate earnings.

However, there are many downside risks, such as the COVID situation, resource price trends, and the impact of China's zero-COVID policy, so the economic recovery is set to be one surrounded by a great deal of uncertainty.

◆ The growth rate will be +2.6% in FY2022

Growth is expected to be +2.6% in FY2022 and +1.4% in FY2023, and these figures exceed the potential growth rate, which is regarded as being somewhere between zero and one percent. This robust growth will be a reflection of the normalization of economic activity as the COVID pandemic ebbs away.

◆ The inflation rate has now risen for nine straight months

The core CPI for May was +2.1% YoY, exceeding the BOJ's inflation target of 2% for the second consecutive month. Higher food and energy prices are driving inflation higher.

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, and the likelihood of inflation quickening significantly, as has happened in Western countries, is low. Core inflation is expected to remain around 2% going forward.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of July 5, 2022)

	(seasonally adjusted, annualized % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2021		1~3	CY2022			CY2023				CY2024	FY2021	FY2022	FY2023
	7~9	10~12		4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	
	(Actual)			(Projection)			(Projection)				(Projection)			
Real GDP	▲ 3.2	4.0	▲ 0.5	5.0	3.2	2.5	1.4	1.2	1.2	0.9	0.9	2.2	2.6	1.4
Private Consumption Expenditure	▲ 4.0	10.1	0.2	6.6	2.2	1.2	1.2	1.0	1.0	0.8	0.8	2.6	3.3	1.1
Housing Investment	▲ 6.6	▲ 4.5	▲ 4.8	4.9	5.2	3.0	0.0	0.5	0.2	0.0	0.0	▲ 1.6	0.6	0.8
Business Fixed Investment	▲ 9.2	0.3	▲ 2.8	4.1	6.4	6.4	3.1	2.8	2.8	2.4	2.4	0.8	2.3	3.4
Private Inventories (percentage points contribution)	(0.3)	(▲ 0.3)	(2.1)	(▲ 0.5)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.2)	(0.0)
Government Consumption Expenditure	4.5	▲ 1.1	2.0	1.2	1.2	1.2	0.4	0.2	0.2	0.2	0.2	2.0	1.2	0.4
Public Investment	▲ 14.6	▲ 17.6	▲ 14.7	7.4	8.9	6.6	▲ 1.2	▲ 0.4	0.0	0.4	0.2	▲ 9.4	▲ 1.6	0.9
Net Exports (percentage points contribution)	(0.4)	(0.4)	(▲ 1.7)	(0.4)	(0.1)	(0.1)	(0.1)	(0.0)	(0.0)	(▲ 0.0)	(▲ 0.0)	(0.8)	(▲ 0.1)	(0.0)
Exports of Goods and Services	▲ 1.1	3.6	4.6	1.0	3.4	4.0	4.0	3.0	3.0	2.6	2.6	12.5	2.9	3.2
Imports of Goods and Services	▲ 3.4	1.4	13.9	▲ 1.1	2.5	3.0	3.0	2.6	2.6	2.4	2.4	7.2	3.2	2.7
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 3.6)	(4.8)	(1.6)	(4.0)	(2.4)	(1.8)	(1.2)	(1.0)	(1.0)	(0.8)	(0.8)	(1.5)	(2.4)	(1.2)
(Ref.) Public Demand (percentage points contribution)	(0.0)	(▲ 1.2)	(▲ 0.4)	(0.6)	(0.7)	(0.6)	(0.0)	(0.0)	(0.0)	(0.1)	(0.1)	(▲ 0.1)	(0.2)	(0.1)

	(% 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	FY2021	FY2022	FY2023
Nominal GDP	0.0	▲ 0.9	▲ 0.1	0.3	2.2	2.7	3.5	2.6	2.4	1.7	1.6	1.2	2.2	2.0
GDP deflator	▲ 1.2	▲ 1.3	▲ 0.5	▲ 1.1	▲ 0.8	0.1	0.2	0.6	0.8	0.6	0.5	▲ 1.0	▲ 0.4	0.6
Consumer Price Index (excluding fresh food)	▲ 0.0	0.4	0.6	2.0	2.1	2.3	2.2	1.7	1.4	1.0	0.6	0.1	2.1	1.2
Unemployment Rate (%)	2.8	2.7	2.7	2.5	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.8	2.5	2.3
Exchange Rates (JY/US\$)	110	114	116	130	134	132	131	128	127	126	125	112	132	127
Import Price of Crude Oil (US\$/barrel)	73	80	85	108	116	111	106	104	106	106	101	76	110	105

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.